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IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

HAROLD W. MANLEY, LOUIS PRADAL, JOHN C. RUDOLPH, DONALD K. RUSSELL and AQUITAINE COMPANY OF CANADA LTD.,

Petitioners,

—against—

DAVID H. SCHOENBAUM,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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March 31, 1969

TABLE OF CONTENTS

	PAGE
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes and Rules Involved	4
Statement of Facts	4
The Parties	4
Background of the Litigation	5
Preparation for Oil Exploration	6
Aquitaine Purchase of 500,000 Shares	6
Protection of Reservoir Information	8
Commencement of the Present Litigation	9
Reasons for Granting the Petition	11
I.—This Court Has Not, But Should, Define the Territorial Limits of the Applicability of the Securities Exchange Act of 1934	11
II.—The Jurisdictional Contacts Presented Here Were Insufficient Under Section 10(b) of the Securities Exchange Act	14
III.—This Case Presents Important Issues Concerning the Scope of Section 10(b) and Rule 10b-5	15

PAGE

CONCLUSION 17

APPENDIX A—Opinion of the District Court A-1

APPENDIX B—Opinion of the Panel of the Court of Appeals B-1

APPENDIX C—Opinion of the Court of Appeals *en banc* .. C-1

APPENDIX D—Judgment of the Court of Appeals D-1

APPENDIX E—Statutes and Rules Involved E-1

TABLE OF AUTHORITIES

Cases

Barnett v. *Anaconda Co.*, 238 F.Supp. 766 (S.D.N.Y. 1965) 15

Birnbaum v. *Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952) 15

O'Neill v. *Maytag*, 339 F.2d 764 (2d Cir. 1964) 15

Ruckle v. *Roto American Corp.*, 339 F.2d 24 (2d Cir. 1964) 15

S.E.C. v. *National Securities, Inc.*, (No. 41, Oct. T. 1968, decided Jan. 27, 1969) 17

Vine v. *Beneficial Finance Co.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967) 15

PAGE

Statutes and Rules

Securities Exchange Act of 1934:
Section 10(b), 48 Stat. 891, 15 U.S.C. § 78j(b) 3, 4, 14, 15, 17
Section 27, 48 Stat. 902, 15 U.S.C. § 78aa 4, 11, 14
Section 30(b), 48 Stat. 904, 15 U.S.C. § 78dd(b) ..4, 13

28 U.S.C. § 1254(1) 2

S.E.C. Rule 10b-5, 17 CFR § 240.10b-5 .....3, 4, 11, 14, 15, 16, 17

Rule 56(e), Federal Rules of Civil Procedure 4

Other Authorities

CCH American Stock Exchange Guide, ¶ 10,008(N) 12

Note, 69 Colum. L. Rev. 94 (1969) 13

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HAROLD W. MANLEY, LOUIS PRADAL, JOHN C. RUDOLPH, DONALD K. RUSSELL and AQUITAINE COMPANY OF CANADA LTD.,

Petitioners,

—against—

DAVID H. SCHOENBAUM,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered on December 30, 1968.

Opinions Below

The opinion of the United States District Court for the Southern District of New York (Hon. Irving Ben Cooper, *J.*), dismissing the complaint on motion for summary judgment, was filed on March 30, 1967, and is reported at 268 F. Supp. 385. The opinion is printed as Appendix A to this petition.

The opinion of the panel of the United States Court of Appeals for the Second Circuit (Lumbard, *Chief Judge;* Medina and Hays, *JJ.*), affirming the judgment of dismissal, was rendered on May 29, 1968 and is reported at 405 F.2d 200. The opinion is printed as Appendix B to this petition.

The contrary opinion of the United States Court of Appeals for the Second Circuit, sitting *en banc,* setting aside the prior opinion of the panel in part and reversing the judgment of the District Court in favor of petitioners, was rendered on December 30, 1968, and is reported at 405 F.2d 215. The opinion is printed as Appendix C to this petition.

Jurisdiction

The judgment of the Court of Appeals *en banc* was rendered on December 30, 1968, and is printed as Appendix D hereto. This petition is being filed on March 31, 1969, within ninety days after the entry of judgment. Jurisdiction is conferred on this Court by 28 U.S.C. § 1254(1).

Questions Presented

1. Merely because shares of a Canadian corporation are listed on an American stock exchange, do the provisions of the Securities Exchange Act of 1934 apply extraterritorially to the issue in Canada by a Canadian corporation of treasury shares to a Canadian purchaser, where the sale was negotiated, executed and otherwise effected entirely outside the United States?

2. Is Section 10(b) of the Securities Exchange Act of 1934, and S.E.C. Rule 10b-5, applicable to a Canadian sale of treasury shares, where the only use of the mails or facilities of interstate commerce was in connection with the mandatory listing (but not for current trading) of those shares with an American stock exchange, and communications between United States counsel for the Canadian issuer and the United States Internal Revenue Service with respect to the equalization tax status of that company's prior issued and outstanding shares?

3. Where Section 10(b) of the Securities Exchange Act of 1934 empowers the Securities and Exchange Commission to promulgate rules governing "manipulative or deceptive devices," is S.E.C. Rule 10b-5 applicable to conduct which involves no element of manipulation or deceit?

4. Where all of the directors of a corporation issuing treasury shares to its principal stockholder, and its principal stockholder, were fully informed concerning all material information which would affect the market price of the issuing company's shares, are the directors and the purchasing stockholder liable in a derivative action under Rule 10b-5 for issuing treasury shares for an allegedly inadequate consideration, merely because material information, learned after the execution of the contract of sale but before delivery and payment, was safeguarded and not disclosed to the general public in accordance with local law?

Statutes and Rules Involved

The Statutes and Rules involved are Sections 27, 30(b) and 10(b) of the Securities Exchange Act of 1934, S.E.C. Rule 10b-5, and Rule 56(e) of the Federal Rules of Civil Procedure. They are set out in Appendix E to this petition.

Statement of Facts

The Parties

Respondent is a shareholder of Banff Oil Ltd. ("Banff"), a corporation organized under the laws of the Province of Alberta, Canada (1, 149).* He commenced this action in the United States District Court for the Southern District of New York derivatively on behalf of Banff, predicating federal jurisdiction on an alleged violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder (1). Banff has no office and conducts no business in the United States (49). Its common stock is listed on the Toronto Stock Exchange and the American Stock Exchange (150).

Petitioners were directors of Banff at the time of the transactions alleged in the complaint, only one of whom (Donald K. Russell) resides in the United States, and Aquitaine Company of Canada Ltd. ("Aquitaine"), a corporation organized under the federal laws of Canada, which is the principal stockholder of Banff (76-77). Petitioners Manley, Rudolph and Russell were not associated with Aquitaine. Aquitaine also has no office and conducts no business in the United States (76).

In the Court of Appeals the Securities and Exchange Commission participated *amicus curiae* by filing a brief with the Court *en banc*.

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* Citations are to the Record filed with this Court.

Background of the Litigation

Banff is a Canadian corporation engaged in the exploration for and production of oil and gas in Canada (48). Banff was incorporated in 1952 (*ibid.*), but until the end of 1963 was a relatively small company carrying out exploration and production functions on a modest scale (49). Its operations were geographically limited almost exclusively to the southeast portion of Alberta because it did not have sufficient resources to engage in high-risk, high-return opportunities in remote areas of Canada (49)

Aquitaine was incorporated in Canada in December 1963 as a wholly owned subsidiary of Societé Nationale des Petroles d'Aquitaine, a French oil company, for the purpose of participating in oil exploration activities in Canada (31, 77). At that time Aquitaine proposed to Banff an interest in participating in oil exploration with Banff as partner and operator (49, 77). This was attractive to Banff because it provided a working associate which had resources sufficient to conduct explorations on a large scale (49). On January 15, 1964 the Banff Board of Directors approved the transmission to the shareholders of Banff of a tender offer by Aquitaine to acquire 1,400,000 outstanding shares of Banff (49-50, 77, 82). The offer was oversubscribed and resulted in the purchase by Aquitaine of 1,468,801 shares (77). On February 3, 1964 three Aquitaine nominees (Messrs. Rutman, Pradal and Le Grand) were elected to the Banff Board of Directors (77). Thereafter, on March 4, 1964, Aquitaine and Banff entered into a partnership agreement under which Banff would conduct oil exploration projects and would share the costs and ownership rights with Aquitaine on the

basis of percentages determined by the nature of the risk involved (50, 77-78).

Preparation for Oil Exploration

On October 14, 1964 Banff, pursuant to its partnership agreement with Aquitaine, negotiated a "farmout agreement" from Socony Mobil Oil of Canada Limited under which Banff and Aquitaine would have the right to earn a 50% interest in approximately 160,000 acres of Crown reservation lands in Northwestern Alberta in return for paying the total cost of drilling two exploratory wells (51, 77-78). Under the partnership agreement Banff was to acquire a 5% interest and Aquitaine a 45% interest, with the costs of drilling to be shared on a substantially proportionate basis (51, 78).

This exploration was to take place in the Rainbow area, a desolate, wilderness region far removed from existing oil production (51). At the time Banff and Aquitaine decided to conduct oil explorations in the Rainbow area, the prospects for success were extremely speculative, as is indicated by the fact that Socony Mobil was willing to give up 50% of its interest to anyone who would drill two wells. At least sixteen wells had previously been drilled in the general vicinity, by six different oil companies, and all had been abandoned as failures (51).

Aquitaine Purchase of 500,000 Shares

In December 1964, as arrangements were being made for the first drilling operation at Rainbow, Banff was not in a financial position to provide its share of the expenses involved in drilling the two test wells (52, 78). At that time Banff had a working capital deficit of approximately $125,000 and its efforts to raise funds by loans or acquisi-

tions of income-producing companies or properties had been unsuccessful (52). Throughout this period, as at all other times, the entire Banff Board of Directors was fully aware of the company's financial condition and oil exploration prospects (52). The Board on December 11, 1964, *with those representing Aquitaine abstaining,* voted to seek the required additional working capital by offering 500,000 shares of capital stock to Aquitaine at the current market price, thereby avoiding underwriting or selling commissions and related expenses (52-53, 78). The President of Banff then submitted a formal written offer to Aquitaine in a letter dated December 14, 1964 (65), and on January 5, 1965 Aquitaine forwarded its formal written acceptance of the proposal (66). The result of the issue of this treasury stock to Aquitaine was to make available to Banff $675,000 in working capital (53), and to make possible the commencement by Banff of exploratory drilling in the Rainbow area (78). The Aquitaine purchase of these shares was announced to the public on January 26, 1965 (67).

Six days after Aquitaine's acceptance of the offer, Banff began drilling the first Rainbow well (54). At that time there was no knowledge or even hint of the value of the discovery that Banff would later make in the Rainbow area (54, 78). Indeed, the only available knowledge concerning the area was the long record of abandoned wells and the small amount of existing seismic data (54). The whole purpose of the treasury stock transaction was to make the exploration possible (54, 78).

Delivery and payment for the shares was delayed until March 15, 1965, because United States counsel for Banff sought, and eventually obtained, a ruling from the United

States Internal Revenue Service that the issue of shares to Aquitaine would not affect the exemption of Banff's outstanding shares under the Interest Equalization Tax (53, 78-79). Also, the mandatory listing of the shares issued to Aquitaine, pursuant to Banff's pre-existing obligation to the American and Toronto Stock Exchanges, was delayed pending a ruling from the Internal Revenue Service (79). These shares were eventually listed but, because of their non-exempt status under the Interest Equalization Tax, they were not listed for current trading on the American Stock Exchange (79).

On March 17, 1965, two days after the delivery and payment for the treasury shares, the first Rainbow discovery well was completed (54, 45-46). At that point it appeared that a new oil and gas resource had been found but, with only the results of a single well, it was impossible to gauge the full extent of that discovery (54, 73). Banff therefore embarked upon an extensive exploration program in the Rainbow area (56-57).

Protection of Reservoir Information

Banff kept its shareholders and the general public apprised of its exploration activities at Rainbow by means of press releases and reports to its public stockholders (60-61, 68-75). Banff did not, however, release detailed information on the nature or extent of the oil and gas reservoirs which were uncovered by its exploration (61, 73). In so doing, Banff was availing itself of a privilege permitted by Alberta law to protect oil reservoir information for one year following the date of discovery (55-56, 102-05). This privilege is afforded by Alberta law to a discovering company in order to allow the company to continue explorations and participate in further Govern-

ment land sales in the area immediately surrounding the discovery, with the benefit of the technical information gathered through the expenditure of its own money and protected from the prying eyes of its competitors (*ibid.*). This privilege is, in effect, an inducement to companies to make investments in exploration of land owned by the Province. As early as March 18, 1965, Banff publicly announced its intention to avail itself of this privilege (73).

During the twelve-month period in which the information was kept confidential, permitting Banff to extend its exploration and bid on Government lands at reasonable prices, Banff was able to drill eighteen additional wells in the Rainbow area, eleven of which indicated potential oil production from four separate reservoirs (62-63). In addition, Banff acquired an interest in over 1,000,000 acres of land along reef fronts similar to those at Rainbow in other parts of Alberta, British Columbia, and the Northwest Territories, and an additional 1,194,000 acres along these fronts in Saskatchewan (62). The latter interests were purchased for less than $2.00 per acre, although Saskatchewan Crown Sales, held after Banff's release of information on the Rainbow discovery well at the expiration of the one-year period, indicated that the per-acre price in the area had at least tripled (*ibid.*).

Commencement of the Present Litigation

At the end of the one-year statutory period, Banff issued a press release (4-5), which described the oil discovery at Rainbow as "amongst the thickest ever encountered in the Province of Alberta" and which has generated "a sharply expanded exploration program in northwest Alberta, Northeast British Columbia and the Northwest Territories." Six days later respondent commenced this

derivative action on behalf of Banff, alleging that the issue of stock to Aquitaine, and a later issue to European investors not involved in this petition, were made for inadequate consideration on the basis of "inside information" (1-9). Respondent does not purport to assert any claim on behalf of persons who purchased or sold Banff's stock.

The defendants other than Banff moved for summary judgment on the grounds that (i) the Securities Exchange Act should not be given extraterritorial application, (ii) no deceit was involved in the sale to Aquitaine, all parties being fully informed, and (iii) no "inside information" existed at the time that the contract of sale between Banff and Aquitaine was made.

The District Court granted the motions for summary judgment, both for lack of subject-matter jurisdiction and for failure to state a claim under the Securities Exchange Act (Appendix A hereto).

On appeal, the Court of Appeals disagreed with the determination that the District Court lacked subject-matter jurisdiction, holding that the Securities Exchange Act did apply to an issue in Canada because of the listing of Banff's stock on an American stock exchange. The original panel of the Court of Appeals, however, affirmed the dismissal of the complaint on the ground that no element of deceit was involved in the issue to Aquitaine (Appendix B hereto).

Respondents' petition for rehearing *en banc* was granted, and the Court of Appeals *en banc* thereafter rendered a new opinion (Appendix C hereto).

The Court of Appeals *en banc* reversed the summary judgment granted to petitioners, holding that Banff could have been defrauded under Rule 10b-5 even in the absence of any deception. The Court reasoned that a question was presented as to the independent judgment of the Banff Board in dealing with the principal stockholder, Aquitaine, and that such action might have constituted a breach of fiduciary duty. Judge Medina dissented, joined by Chief Judge Lumbard and Judge Moore (C-9 to C-12).

Reasons for Granting the Petition

I.

This Court Has Not, But Should, Define the Territorial Limits of the Applicability of the Securities Exchange Act of 1934.

The Court of Appeals majority in this case has held that the mere listing of a foreign issuer's securities on an American exchange is sufficient to justify the extraterritorial application of the Securities Exchange Act of 1934 ("the Act") to a transaction occurring off the exchange and entirely outside of the United States.* In light of the sweeping jurisdictional language found in Section 27 of the Act, it thus becomes possible for a District Court to proceed with personal jurisdiction over foreign defendants with respect to transactions in securities carried out anywhere in the world, merely because the issuer had securities listed on an American exchange.

* The original panel of the Court of Appeals (Appendix B) considered the jurisdictional application of the Act, and this decision was adopted without further discussion by the full Court (Appendix C).

Congress never contemplated such a result. In any event, the substantial number of foreign corporations having shares listed on American exchanges suggests that this Court should definitively resolve the scope of the Act's extraterritorial application.

The total absence of impact upon United States exchanges or the United States securities markets is apparent from the factual context in which this action arose. The outstanding shares of Banff, a Canadian company whose outstanding shares were predominantly owned by "United States persons" at the time when the Interest Equalization Tax became effective, were exempted from payment of that tax. However, the treasury shares issued to Aquitaine were not exempt from the Interest Equalization Tax, except upon the original issue to that Canadian company; thereafter the tax would be payable unless those shares were acquired from a "United States person." The communications between Banff's United States counsel and the Internal Revenue Service were motivated by a desire for assurance that the issuance of non-exempt shares to Aquitaine would not jeopardize the exempt status of Banff's already outstanding shares. Only after the Internal Revenue Service was satisfied that the shares to be issued to Aquitaine would be represented by certificates, distinctive in color and legend from the previously outstanding certificates, in order to give notice of their tax status, was a ruling received confirming the continued exemption of Banff's previously outstanding shares. The way was then clear for Banff to comply with its pre-existing obligation to the American Stock Exchange to list any additional shares issued (see CCH *American Stock Exchange Guide*, ¶ 10,008 (N)).

Because the shares issued to Aquitaine were not exempt from the Interest Equalization Tax, the American Stock Exchange admitted those shares to listing only under a separate designation (reflecting their tax status), and noted that those shares would not constitute valid delivery of Banff's tax-exempt stock on purchases executed on the Exchange. Thus, the issuance of the shares to Aquitaine had no market effect in the United States.

The Court of Appeals held, however, that the Act had extraterritorial application "to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities" (B-7). Even assuming the dubious correctness of that characterization of the transaction and Congressional intent, the realities of the case do not meet those standards. Congress in fact was aware that the application of the Federal securities laws to foreign transactions involves delicate questions which could not adequately be dealt with in a statute of general terms. Thus, Congress in Section 30(b) of the Act indicated that foreign transactions would be covered only in particular situations where regulation became necessary, as determined by the Commission after additional experience had been obtained in this area. Thus § 30(b) of the Act affords an exemption "unless in contravention of such rules and regulations as the Commission may prescribe".* In the 35-year life of

* In construing the extraterritorial application of the Act, the Commission enjoys a necessary flexibility to prevent interference with international relations. In its rule-making procedures, where comments are solicited from interested parties, the Commission has a flexibility not usually possessed by the Federal courts, which can announce a rule of law only in a case or controversy. See generally Note, 69 COLUM. L. REV. 94, 111 (1969).

the Act, the Commission has never adopted a regulation which would subject foreign transactions to the provisions of the Act. Absent such regulation by the Commission, the wholly foreign transaction challenged by respondent in this case is beyond the jurisdiction of the Federal courts.

II.

The Jurisdictional Contacts Presented Here Were Insufficient Under Section 10(b) of the Securities Exchange Act.

Section 10(b) of the Act requires, as a condition precedent to any claim for relief, that the transaction involve the "use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange." It should be apparent that communications by Banff's United States counsel with the Internal Revenue Service, and Banff's compliance with the preexisting agreement to list the shares issued to Aquitaine with the American Stock Exchange, were not an integral part of the one transaction which the Court of Appeals held subject to Rule 10b-5. Yet these were the only jurisdictional contacts upon which respondent could rely, and such a slender reed was held sufficient by the Court of Appeals. Certainly Congress never intended in 1934 the unbecoming result that merely because of the listing of a foreign security upon an American exchange—a result to be encouraged in the interest of American investors and the growth of American securities markets—a wholly foreign transaction between foreign nationals could be the subject of suit in American courts by extraterritorial service of process under Section 27 of the Act.*

* Only one of the petitioners (Russell) was served with process in the United States. The others were served in Canada.

III.

This Case Presents Important Issues Concerning the Scope of Section 10(b) and Rule 10b-5.

Congress in enacting Section 10(b) conferred jurisdiction on the Commission to regulate any "manipulative or deceptive device or contrivance". Until this case was decided by the Court of Appeals, the lower courts had generally considered either deception or the existence of a market manipulation (which is not involved here) to be necessary elements of a claim under Section 10(b) and Rule 10b-5.*

Thus, a general assertion that conduct violated common law obligations of directors was held insufficient to state a federal claim under this section, absent *scienter* or deception. In *O'Neill* v. *Maytag*, 339 F.2d 764 (2d Cir. 1964), the Court of Appeals so concluded:

> "The question posed by this case is whether it is sufficient for an action under Rule 10b-5 to allege a breach of one of these general fiduciary duties where the breach does not involve deception. We think it is not: At least where the duty allegedly breached is only the general duty existing among corporate officers, directors and shareholders, no cause of action is stated under Rule 10b-5 unless there is an allegation of facts amount[ing] to deception." *Id.*, at 767-68.

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* See, *e.g.*, *Vine* v. *Beneficial Finance Co.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967); *O'Neill* v. *Maytag*, 339 F. 2d 764 (2d Cir. 1964); *Ruckle* v. *Roto American Corp.*, 339 F.2d 24 (2d Cir. 1964); *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952); *Barnett* v. *Anaconda Co.*, 238 F. Supp. 766 (S.D.N.Y. 1965).

In this case, a sale to Paribas Corporation, a party in the lower courts but not here, admittedly made with knowledge of material information, was held not violative of Rule 10b-5 because of the absence of any deception. The Court of Appeals majority sustained federal jurisdiction over petitioners only because of the possibility—ephemeral indeed on this documentary record—that Banff's directors may not have exercised "independent judgment" in dealing with Aquitaine, Banff's majority stockholder. Questions of that nature, however, were dealt with as a matter of local law long before the Act was adopted and it is a perversion of congressional intent to suggest that the Act was designed to proclaim a new federal body of law governing the fiduciary duties of corporate directors—even when the corporation was organized under foreign law and the directors were themselves foreign nationals.

Giving to respondent the benefit of every possible pleading doubt, the only issue in the case is whether Banff, a Canadian corporation, issued treasury shares to Aquitaine in Canada for an inadequate consideration. Local law in every civilized jurisdiction has always been considered adequate to cope with questions such as these. To equate "independence" of Canadian directors in a Canadian transaction with the statutory standard of a "manipulative or deceptive device or contrivance" is hardly more than nonsense.

As stated by Judge Medina in cogent dissent (C-9 to C-12), the evidence submitted by the petitioners estab-

lished that no material information was known to any party prior to January 5, 1965, when the Aquitaine contract of sale was made. Since no material information was then known to the Banff directors, it is difficult to understand how their motive, intent or "independence" could have any conceivable relevance to an asserted claim under Rule 10b-5.

CONCLUSION

The lower Federal Courts now cope with a deluge of suits involving alleged violations of Section 10(b) and Rule 10b-5, many of them involving foreign transactions. The *en banc* decision of the Court of Appeals will add to the deluge a host of cases concerned only with common law waste in every situation in which an ingenious plaintiff's lawyer can spell out some connection, however tenuous, with the issuance or sale of a "security". This Court should provide guidance to the lower courts, not only with respect to the extent of the territorial application of the Securities Exchange Act, but also with respect to the necessary elements involved in a claim under this most litigated of rules, an issue left open by this Court in *S.E.C.* v. *National Securities, Inc.* (No. 41, Oct. T. 1968, decided Jan. 27, 1969).

The petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit should be granted.

Respectfully submitted,

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March 31, 1969

APPENDIX A

Opinion of the District Court

APPENDIX A

Opinion of the District Court

DAVID H. SCHOENBAUM,

Plaintiff,

—v.—

BRADSHAW D. FIRSTBROOK, JEAN-PAUL LEGRAND, HAROLD W. MANLEY, LOUIS PRADAL, JOHN C. RUDOLPH, DONALD K. RUSSELL, GILBERT RUTMAN, SAMUEL WATKIN, AQUITAINE COMPANY OF CANADA, LTD., PARIBAS CORPORATION OF NEW YORK and BANFF OIL LTD.,

Defendants.

No. 66 Civ. 856

UNITED STATES DISTRICT COURT

S. D. NEW YORK

March 30, 1967

Sidney B. Silverman, New York City, for plaintiff.

Simpson, Thacher & Bartlett, New York City, for defendants Harold W. Manley, John C. Rudolph and Donald K. Russell; Whitney North Seymour, Jr., and John C. Diller, New York City, of counsel.

Sullivan & Cromwell, New York City, for defendants Aquitaine Co. of Canada, Ltd. and Louis Pradal; Marvin Schwartz, and Michael M. Maney, New York City, of counsel.

White & Case, New York City, for defendant Paribas Corp. of New York; David Hartfield, Jr., and Thomas A. Butler, New York City, of counsel.

Roth, Carlson, Kwit & Spengler, New York City, for defendant Banff Oil Ltd.; Robert S. Carlson, New York City, of counsel.

OPINION

IRVING BEN COOPER, *District Judge.*

Plaintiff, a shareholder of defendant Banff Oil Ltd. (Banff), brings this action under the Securities Act of 1933, 15 U.S.C. § 77a et seq., and the Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq. Defendants are Banff and its individual directors, Aquitaine Company of Canada, Ltd. (Aquitaine), Banff's controlling stockholder, and the Paribas Corporation of New York (Paribas). Plaintiff asserts that the use of "inside information" by the defendants in three transactions involving the sale of Banff stock violated the aforementioned Acts. Defendants, other than Banff, move for summary judgment.

The first transaction complained of is a tender offer made by Aquitaine with the approval of the Banff Board of Directors on January 15, 1964[1] to Banff shareholders for the purchase of some 1,400,000 shares of Banff common stock.

The second transaction concerns a purchase by Aquitaine of 500,000 Banff treasury shares. Plaintiff alleges that this purchase was consummated on or about March 15, 1965. Defendants assert that there was a binding contract as of January 5, 1965 when Aquitaine accepted

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[1] The complaint alleges the date of the Aquitaine tender offer to be January 15, 1965. However, in his Memorandum of Law, plaintiff's attorney agrees that 1964 is the correct date.

There is no allegation that Aquitaine had any control over Banff prior to the tender offer.

Banff's offer to sell of December 14, 1964, and that only delivery was effected in March. We regard any discrepancy that apparently exists in this respect as of no importance for purposes of this motion.

The third transaction, taking place in late 1965 and early 1966, involved the sale of 270,000 treasury shares by Banff. Defendants allege that the purchaser was Banque de Paris et des Pays-Bas pour le Grand Duche de Luxembourg (Pays-Bas Luxembourg), a French banking firm which is not a party to this action. Defendant Paribas, a Delaware corporation with offices in New York City and a wholly owned subsidiary of Pays-Bas Luxembourg, asserts it acted solely as an agent and consultant for its parent. The complaint is unclear as to whether Paribas acted as agent or principal in the sale. (See Complaint, para. 13(b)) Plaintiff's Memorandum of Law (p. 7) clarifies this by stating that the sale was "to customers of Paribas."

The complaint charges that in all three transactions the respective purchasers defrauded their sellers in that they bought with "inside information." It alleges that for some time prior to February 6, 1965 defendants knew that Banff was developing extremely valuable oil fields in western Canada, information undisclosed to the public or to Banff shareholders, and which affected to an impressive extent the price of Banff shares. The market price of those shares has since risen considerably above the highest price paid in any of the three sales complained of.

The heart of the complaint is that the use of inside information violated section 10(b)[2] of the 1934 Act and

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[2] 15 U. S. C. §78j(b) provides: It shall be unlawful for any person, directly or indirectly, by the use of any means or instru-

Rule 10b-5[3] promulgated thereunder. Defendants counter that as to all three purchases there is no cause of action stated under section 10(b); that there is no subject matter jurisdiction with respect to the Aquitaine and Paribas treasury stock purchases.

The Aquitaine Tender Offer

We do not find any cause of action to exist as to the Aquitaine tender offer to Banff's shareholders. The complaint alleges that plaintiff has owned his shares continuously since 1959. It does not allege that plaintiff sold any shares to Aquitaine as part of the 1964 tender offer. Accordingly, plaintiff presents no representative claim arising from that transaction.

In contemplation of law, the corporation does not have a claim under section 10(b). Even if control was acquired

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mentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[3] 17 C. F. R. §240.10b-5 provides: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange

(1) To employ any device, scheme or artifice to defraud,

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

as part of a fraudulent scheme, there is no injury to the corporation within the meaning of section 10(b) upon which a derivative action can be based. Further, any damage resulting from alleged acts of corporate waste committed by those who so gained control does not constitute a cause of action under section 10(b). Hoover v. Allen, 241 F.Supp. 213, 228-229 (S.D.N.Y.1965).

The Aquitaine and Paribas Treasury Stock Purchases

Although plaintiff has termed his action representative as well as derivative, no representative claim has in fact been asserted. If the corporation has a claim under section 10(b), a shareholder has standing to sue only on a derivative basis. Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952), cert. denied, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952); Slavin v. Germantown Fire Ins. Co., 174 F.2d 799, 805-806 (3d Cir. 1949); Surowitz v. Hilton Hotels Corp., 342 F.2d 596, 604 (7th Cir. 1965), rev'd. on other grounds, 383 U.S. 363, 86 S.Ct. 845, 15 L.Ed.2d 807 (1966).

Defendants assert defenses of lack of jurisdiction and legal insufficiency. It is advisable at this point to review the evidence submitted to this Court.

Defendants have complied with the mandate of Rule 56(e) and have adduced numerous documents in the form of affidavits and exhibits attesting to their version of the facts.

Plaintiff's papers consist of: (1) The verified complaint made upon information and belief. Because the complaint is verified, it will be regarded as an affidavit. However, it is clear that an affidavit made on information and belief can not support on summary judgment the averments it attempts to uphold. Automatic Radio Manufacturing

Co., Inc. v. Hazeltine Research, Inc., 339 U.S. 827, 831, 70 S.Ct. 894, 94 L.Ed. 1312 (1950); 6 Moore, Federal Practice, ¶ 56.22 [1], p. 2806 (1965). (2) A brief affidavit in opposition by the attorney for plaintiff. (3) The Memorandum of Law submitted by the same attorney to the contents of which he refers in his affidavit as setting forth the facts. Again, these documents do not meet the standards prescribed by Rule 56(e). Certainly, statements in briefs are not considered as evidence on a summary judgment motion and do not controvert evidence submitted by the movants. Lane v. Greyhound Corp., 13 F.R.D. 178 (E.D.Ky.1952); United States v. Jones, 155 F.Supp. 52, 56 (M.D.Ga.1957); Allen v. Radio Corp. of America, 47 F.Supp. 244, 246 (D.Del.1942). Moreover, even if we were to regard the memorandum as being incorporated by reference into the attorney's affidavit, the result is an affidavit clearly made without personal knowledge and clearly insufficient. Berkley v. Clark Equipment Co., 22 F.R.D. 487 (E.D.N.Y.1958); Abel v. Morey Machinery Co., 10 F.R.D. 187 (S.D.N.Y.1950); Frost v. Bankers Commercial Corp., 11 F.R.D. 195 (S.D.N.Y.1951), aff'd sub nom. The Constellation (Frost v. Bankers Commercial Corp.), 194 F.2d 505 (2d Cir. 1952).

The papers thus present a situation where as to certain vital factual matters defendants have submitted impressively sound, credible evidence as against plaintiff's barrenness. On summary judgment, as at trial, resolution of the factual contention must be made in favor of the party supporting his position with evidence.

To do otherwise would emasculate summary judgment, making it but another motion for judgment on the pleadings or to dismiss for legal insufficiency. And it is well established that on summary judgment the court is not limited to the questions raised by the pleadings, for sum-

mary judgment may be granted when the affidavits in support of the motion pierce the alleged issues of fact raised by the pleadings. 6 Moore, supra ¶ 56.11 [3], pp. 2161, 2167-68; 3 Barron & Holtzoff § 1235.1 (1958); Topp-Cola Co. v. Coca-Cola Co., 185 F.Supp. 700, 707 (S.D.N.Y.1960); Dale Hilton, Inc. v. Triangle Publications, Inc., 27 F.R.D. 468, 470 (S.D.N.Y.1961); Dressler v. MV Sandpiper, 331 F.2d 130, 132-133 (2d Cir. 1964).

Jurisdiction

In determining jurisdiction the Aquitaine and Paribas transactions are regarded as distinct and separate. Defendants have submitted sworn affidavits persuasively attesting to the lack of connection between the Aquitaine and Paribas stock purchases. (Rutman Affidavit, para. 9, Michel Affidavit, para. 3). The complaint makes accusations of some "conspiracy." In attempting to support this, plaintiff's attorney notes that Aquitaine and its controlling interests are French; Paribas is owned by a French bank, the stock received in the Paribas transaction was ultimately placed with ten French investors. We do not regard this as being of the stuff of which conspiracy charges are upheld. We believe summary disposition of this contention appropriate. See Scolnick v. Lefkowitz, 329 F.2d 716 (2d Cir. 1964).

The Aquitaine-Banff Transaction: Jurisdiction

Affidavits submitted by the Presidents of Aquitaine and Banff concerning the Aquitaine-Banff transaction attest: Negotiations, the exchange of offer and acceptance, and delivery of the shares occurred in Canada; payment was made in Canada and in Canadian funds; no part of the trans-

action occurred in the United States. (Rudolph Affidavit, para. 11; Rutman Affidavit, para. 9). Plaintiff sets forth no factual allegations that contradict that this was solely a Canadian transaction. Instead, he has denominated defendants' affidavits as "self-serving" and contends that he should test the credibility of defendants at trial. Where plaintiff has produced nothing to support the facts essential to his claim, he is not entitled to a trial solely on the issue of the credibility of defendants' witnesses. We would not, on summary judgment, resolve a genuine issue of credibility.

> "But this does not mean that any plaintiff, armed with a complaint barely sufficient to survive a motion to dismiss, can force a defendant to a protracted trial merely by suggesting that the defendant's affidavits may be false. Such a rule would make a mockery of the summary judgment procedure under Rule 56." Topp-Cola Co. v. Coca Cola Co., supra, 185 F.Supp. at 708.

We regard this most proper pronouncement as warranting the strictest applicability here. Plaintiff has charged fraud and conspiracy—charges easy to fling and possessing serious consequences for the accused. Those making such accusations should be prepared to produce evidence as to their validity.

Accordingly, the papers submitted permit no other inference than that a Canadian corporation was allegedly defrauded by its principal shareholder, also a Canadian, the fraud being executed and consummated outside of the United States. The one United States contact present is Banff's listing on the American Stock Exchange. However,

the fraud alleged has nothing to do with Banff shares traded on the American Exchange. The exchange facilities were irrelevant to the transaction complained of.

Absent the presence of an extra-territorial function in the Exchange Act, these United States contacts are too insubstantial to warrant application of section 10(b) to this Canadian transaction. Our interpretation of the statute and its purpose as applied here make inapplicable any such extra-territorial test.

It is a standard canon of construction that " * * * legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States * * * . It is based on the assumption that Congress is primarily concerned with domestic conditions." Foley Bros. Inc. v. Filardo, 336 U.S. 281, 285, 69 S.Ct. 575, 577, 93 L.Ed. 680 (1949); Blackmer v. United States, 284 U.S. 421, 436-437, 52 S.Ct. 252, 76 L.Ed. 375 (1932). In the two cases where this Court has considered the extra-territorial effect of the Exchange Act, it has held that there is nothing in the statute or its legislative history suggesting that the statute was designed to apply outside the territorial jurisdiction of the United States. Ferraioli v. Cantor, CCH Fed. Sec.L.Rep. ¶ 91615 (S.D.N.Y.1965); Kook v. Crang, 182 F.Supp. 388, 390 (S.D.N.Y.1960).

The normal presumption of territoriality is reinforced by the specific mandate of section 30(b), 15 U.S. § 78dd(b), which provides:

> The provisions of this title or of any rule or regulation thereunder shall not apply to any person in so far as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations

as the Commission may prescribe as necessary or appropriate to prevent the evasion of this title.

This Court has previously noted in a suit brought under Rule 10-5: "Surely, if Congress intended to exempt from the Act those persons who are extra-territorially engaged in the securities business, it intended to exempt those who extra-territorially enter into a single, isolated sale of securities." Ferrajoli v. Cantor, supra at 95317.

Choice of Law Principles

We recognize in choice of law principles strong reasoning why this transaction is governed by Canadian law. The complaint essentially alleges a breach of the directors' fiduciary duty—expanded to include the fiduciary obligation of a controlling shareholder and a "tippee." The determination of a director's fiduciary duty to the corporation and its shareholders is governed by the law of the state of incorporation. Hausman v. Buckley, 299 F.2d 696, 93 A.L.R. 2d 1340 (2d Cir.), cert. denied, 369 U.S. 885, 82 S.Ct. 1157, 8 L.Ed.2d 286 (1962); Geller v. Transamerica Corp., 53 F.Supp. 625, 629 (D.Del.1943) aff'd 151 F.2d 534 (3d Cir. 1945); Restatement, Conflicts of Laws §§ 187, 199 comment a (1934); Restatement 2d, Conflicts of Laws, § 187 (Tentative Draft No. 7 (as revised) April 15, 1963). The only exception to this principle that has developed are those cases which found the corporation to be foreign in name only. See Note, 108 U.Pa.L.Rev. 742, 745 (1960); Mansfield Hardwood Lumber Co. v. Johnson, 268 F.2d 317 (5th Cir.), cert. denied, 361 U.S. 885, 80 S.Ct. 156, 4 L.Ed.2d 120 (1959). This factor is not present here.

The reason for this rule is the legitimate interest of all in the certainty of governing relationships *inter sese* of the

corporation, directors and shareholders by a single law. See Reese & Kaufman, The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit, 58 Colum.L.Rev. 1118, 1125 (1958). In this way, the reasonable expectations of the parties are protected. Directors would not suddenly find an action, executed and legal in the state of incorporation, attacked under a contrary rule of a foreign state. A shareholder, who has voluntarily invested, can reasonably be presumed to have agreed that his relationship with the corporation is governed by the laws of the state of incorporation. Certainly, here, a shareholder in a Canadian corporation cannot be heard to complain that his company's activities in Canada are without the benefit of United States law.

We recognize that choice of law principles are not determinative as to whether Congress intended the Exchange Act to have extra-territorial effect. However, the reluctance of one state to interfere with the obligations a sister state has imposed on a corporation, its directors and shareholders, is strengthened when the problem is that of one country imposing its standards of corporate behavior on another. Cf. Steele v. Bulova Watch Co., 344 U.S. 280, 288-289, 73 S.Ct. 252, 97 L.Ed. 252 (1952). If the impact of such foreign transactions on the American securities market is of concern, the S.E.C. has power to make appropriate rules. See section 30(b) of the Exchange Act. The failure of the S.E.C. to do so in an obvious situation is further indication of the lack of interest by the United States in such transactions.

Plaintiff, in urging the extra-territorial application of the Exchange Act, relies upon those cases enunciating the "protective principle" of jurisdiction: "Acts done outside a jurisdiction, but intended to produce and producing detri-

mental effects within justify a state in punishing the cause of the harm as if he had been present at the effect, if the state should succeed in getting him within its power." Strassheim v. Daily, 221 U.S. 280, 285, 31 S.Ct. 558, 560, 55 L.Ed. 735 (1911); Ford v. United States, 273 U.S. 593, 47 S.Ct. 531, 71 L.Ed. 793 (1927); United States v. Aluminum Company of America, 148 F.2d 416, 443 (2d Cir. 1945). Plaintiff's claim being solely derivative, any harm was to a Canadian corporation. We find no allegation of harm occurring within the United States to support the application of this principle.

Recent developments in the extra-territorial application of economic regulation statutes indicate the need for more substantial United States contacts than are here present. In Steele v. Bulova Watch Co., supra, relied upon by plaintiff, the Supreme Court found infringement of plaintiff's trademark in Mexico to constitute a claim under the Lanham Act for unfair competition. However, certain decisive factors were present in *Steele*; the equivalent is totally absent here. (1) Defendant in *Steele* was a United States citizen. (2) The components were purchased in the United States. (3) The spurious goods affected plaintiff's reputation. (4) Spurious goods filtered back into the United States. See also Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690, 704-705, 82 S.Ct. 1404, 8 L.Ed.2d 777 (1962).

In the instant case, no effects on United States commerce are alleged to have occurred. What is alleged—a fraud on a foreign corporation, by foreigners, in a foreign country—is not within the purview of the Exchange Act. Cf. Vanity Fair Mills, Inc. v. T. Eaton Co., 234 F.2d 633 (2d Cir.), cert. denied, 352 U.S. 871, 77 S.Ct. 96, 1 L.Ed.2d 76 (1956).

The Paribas Transaction: Jurisdiction

Defendants have submitted affidavits attesting to the Canadian nature of the Paribas-Banff treasury stock purchase: negotiations were conducted in Canada and France, the purchase was executed, payment made, and the shares delivered in Canada. (Rudolph Affidavit, paras. 17-18; Michel Affidavit, para. 3). The President of Paribas submits that Paribas acted solely as an agent for Pays-Bas Luxembourg, serving as a conduit and a consultant. (Michel Affidavit, para. 3). Defendants' papers reveal, however, that the offer was sent by Paribas from New York to Banff in Canada. (See Exhibit A to Michel Affidavit).

Plaintiff's complaint and Memorandum of Law asserts that the transaction took place in New York. (Complaint, para. 18(c); Memorandum, p. 25). In view of the principles of summary judgment discussed above, we do not regard this declaration—unsupported by anything approaching evidence—as giving rise to a genuine, contested issue of fact.

The affidavit of plaintiff's attorney also asserts that the stock sold—allegedly a private placement with European investors—is now being traded in the United States. He submits that he has been told this by a broker. Affidavits on summary judgment must present evidence which would be admissible at trial. Instead we are offered rank hearsay; we disregard it. 6 Moore, supra, ¶ 56.22 [1], p. 2807-08; Universal Films Exchanges, Inc. v. Walter Reade, Inc., 37 F.R.D. 4, 5 (S.D.N.Y.1965); Smerdon v. Swedish-American Line, 33 F.R.D. 314, 315 (S.D.N.Y.1963).

We cannot look upon this one isolated and incidental act of mailing the offer from New York to Canada as changing

what again is an essentially Canadian transaction into one subject to the fraud rules of the Exchange Act. Any fraud occurred in Canada and is without effect upon the United States securities markets. Considered in context, this single use of the United States mails is insufficient a contact to subject the entire Canadian transaction to the provisions of section 10(b). See Kook v. Crang, supra, where this Court held that the margin requirements of the Exchange Act did not apply to a Canadian brokerage transaction despite the comparatively frequent use of United States mails and facilities in furtherance of a brokerage enterprise.

The cases relied upon by plaintiff presented much more substantial United States connections than here involved. In the second Ferraioli v. Cantor case, CCH Fed.Sec.L.Rep. ¶ 91,704 (S.D.N.Y.1966) the court found that the amended complaint alleged that an integral part of the fraud was consummated in New York City. In Securities and Exchange Commission v. Gulf Intercontinental Finance Corp., 223 F.Supp. 987 (S.D.Fla.1963) the court found the scheme there involved had been conceived and operated within the United States.

Legal Sufficiency

Plaintiff charges that the Aquitaine and Paribas purchases of Banff treasury stock was made on the basis of inside information and in violation of section 10(b) and Rule 10b-5. Imperatively resolved is the proposition that the use of inside information in certain circumstances is a fraud within the meaning of section 10(b). See Securities and Exchange Commission v. Texas Gulf Sulphur, Inc., CCH Fed.Sec.L.Rep. ¶ 91805 (S.D.N.Y.1966); Kardon v. National Gypsum Co., 73 F.Supp. 798 (E.D.Penn.1947).

Equally clear it is that where the corporation has been defrauded in the issuance of its stock within the meaning of section 10(b) and Rule 10b-5, a stockholder may assert derivatively his corporation's claim. Hooper v. Mountain States Securities Corp., 282 F.2d 195 (5th Cir. 1960), cert. denied, 365 U.S. 814, 81 S.Ct. 695, 5 L.Ed.2d 693 (1961); New Park Mining Co. v. Cramner, 225 F.Supp. 261 (S.D. N.Y.1963); Kane v. Central American Mining & Oil, Inc., 235 F.Supp. 559 (S.D.N.Y.1964).

The essential fact here is that plaintiff alleges, and defendants concede, that all members of Banff's Board of Directors had full knowledge of the oil drilling activities which constituted the secret inside information.[4] There is no allegation that any affirmative misrepresentations were made. It is precisely the absence of this factor which distinguishes this case from Dembitzer v. The First Republic Corp. of America, CCH Fed.Sec.L.Rep. ¶ 91,445 (S.D.N.Y. 1964) and Heilbrunn v. Hanover Equities Corp., CCH Fed. Sec.L.Rep. ¶ 91706 (S.D.N.Y.1966), relied upon by plaintiff.

Plaintiff is in effect urging as a principle of law that anyone buying with inside information has automatically violated Rule 10b-5. We regard this as contrary to both normal business practices and the logic of the Rule's admonition.

The fraud involved in buying or selling on the basis of inside information is based first on the user's relationship

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[4] Defendants have submitted extensive affidavits attempting to demonstrate that at the time of these transactions (which is in dispute) the drilling had not reached such a point as to provide material information. See List v. Fashion Park, Inc., 340 F.2d 457 (2d Cir.), cert. denied, 382 U.S. 811, 86 S.Ct. 23, 15 L.Ed.2d 60 (1965). We do not regard defendants' papers as having clearly established this, and, accordingly, assume for purposes of this motion, that defendants did have material information unknown to the general public.

with the corporation being such as to allow him access to information intended only for a corporate purpose—not for his personal benefit. For the instant, we shall assume this to have been met.[5] Secondly, the fraud rests " • • • upon the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing." Cady, Roberts & Co., 40 S.E.C. 907, 912 (1961). Where, as plaintiff alleges here, *both* parties had full knowledge, there is no fraud upon either party resulting from the use of this knowledge.

Accordingly, we find no cause of action asserted against Paribas. No authority has ever suggested that two parties, both having information unknown to the world at large, cannot deal with each other. The cases are to the contrary. See Kohler v. Kohler Co., 319 F.2d 634 (7th Cir. 1963); Nemitz v. Cunny, 221 F.Supp. 571, 575 (N.D.Ill.1963).

The rule does not impose a general obligation to publicly disclose all business secrets, when sound practice indicates discretion. See Fleischer, Securities Trading and Corporate Practices: The Implications of The Texas Gulf Sulphur Proceedings, 51 Virg.L.Rev. 1271, 1304 (1965). To hold otherwise would effectively bar an arms-length transaction between a corporation needing funds to develop a "secret" discovery and an investor whose very incentive to invest stems from his knowledge of the corporate secret.

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[5] Aquitaine, as the controlling share holder of Banff, is held to the same standard of fiduciary duty as a director. Cochran v. Channing Corp., 211 F.Supp. 239, 242 (S.D.N.Y. 1962). Paribas' position is that of "tippee." See Cady, Roberts & Co., supra; Painter, Inside Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10b-5, 65 Colum. L. Rev. 1361, 1385-1390 (1965).

The Aquitaine Purchase

We regard the Aquitaine purchase as being more troublesome. Aquitaine's position as Banff's controlling shareholder and its direct representation on Banff's Board of Directors gives flash credence to plaintiff's innuendoes of a fraudulent scheme.

The "fraud" charged here, however, cannot rest on the use of inside information, for all parties knew all material facts. However, a breach of fiduciary duty is alleged. Although perhaps actionable under state corporate law, we are disinclined to hold this as stating a cause of action under section 10(b).

There is general agreement that not every breach of a fiduciary obligation imposed by state law is also a violation of section 10(b). Note, 50 Cornell L.Q. 545, 546-47 (1965); Fleischer, "Federal Corporation Law": An Assessment, 78 Harv.L.Rev. 1146, 1166 (1965). The import of two recent cases in our circuit indicates that the violation of a fiduciary duty does not constitute a cause of action under section 10(b) and Rule 10b-5 absent any affirmative misrepresentation or breach of an affirmative duty to disclose.

In Ruckle v. Roto American Corp., 339 F.2d 24 (2d Cir. 1964), the court held that the complaint stated a cause of action under section 10(b) where it was alleged that as part of a scheme to perpetuate control, treasury shares were issued to a director at an arbitrarily low price and that information as to the latest financial statement of the corporation was purposefully withheld from some directors. In O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964) the court affirmed the dismissal of the complaint where it alleged that the Board of Directors, as part of a scheme

to perpetuate control, approved a stock swap at a ratio unfavorable to the corporation. The crucial distinction between the cases is the absence in *Maytag* of deceit of any kind, affirmative misrepresentation or failure to disclose, on the decision-making body.

The *Maytag* court stated:

> "* * * where the duty allegedly breached is only the general duty existing among corporate officers, directors and shareholders, no cause of action is stated under Rule 10b-5 unless there is an allegation of facts amounting to a deception.
>
> Our conclusion follows from our view of the purpose of § 10(b): "[T]hat section was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs." Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir.), cert. denied, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952). O'Neill v. Maytag, supra, at 768.[6]

At best, the facts alleged here support a charge of fraudulent mismanagement of corporate affairs. The absence of any deception limits the analogy to traditional common law fraud upon which section 10(b) is based. See Note, supra, 50 Cornell L.Q. at 547; Fleischer, supra, 78 Harv.L.Rev. at 1166. The misappropriation or waste of

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[6] Compare the observation of the *Ruckle* court: "It may be that there was no concealment of material facts at the board of directors meeting at which the transactions were approved." This, the court stated, went to the merits of the case. Ruckle v. Roto American Corp., supra, 339 F.2d at 29.

corporate assets, also present in *Maytag*, is not the fraud to which section 10(b) was directed. See also Carliner v. Fair Lanes, Inc., 244 F.Supp. 25 (D.Md.1965). Plaintiff, accordingly, can receive no support from the language of the *Ruckle* court that all the directors can defraud their corporation, when the "fraud" complained of is not "fraud" within the meaning of section 10(b).[7]

Other Sections Invoked

We find no cause of action alleged under section 9(a) (4)[8] of the Exchange Act. There has been no assertion of misrepresentation by the purchaser to the seller. See Elfenbein v. Yaeger, CCH Fed.Sec.L.Rep. ¶ 91368 (S.D.N.Y. 1964).

No cause of action under sections 12(2)[9] and 17[10] of the Securities Act has been pleaded. These sections, imposing liability on the seller of the security, create a cause of action only in a defrauded purchaser. Slavin v. Germantown Fire Ins. Co., supra; Birnbaum v. Newport Steel Corp., supra. Neither the corporation nor plaintiff are purchasers of securities.

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[7] But see Heilbrunn v. Hanover Equities Corp., supra, where the court said: "* * * it is clear that the corporation, as seller of stock and claimant in the third count, may be defrauded by all of its directors, and is not barred from relief by the notion of imputed knowledge." However, the complaint there charged definite affirmative misrepresentations were made. The court held that the causal connection between the misrepresentations and the wrong to the corporation was a matter of proof at trial.

[8] 15 U.S.C. § 78i(a) (4).

[9] 15 U.S.C. § 77*l*(2).

[10] 15 U.S.C. § 77q.

Discovery

Plaintiff urges that we grant him full discovery before proceeding to summary judgment against him. We deny this request.

We note at the outset plaintiff's failure to comply with the procedure directed by Rule 56(f). Moreover, disregarding form, we find that the "facts" plaintiff wishes to discover are irrelevant to the grounds of this decision.

Extracting to the utmost in plaintiff's favor, we discern no merit in prolonging this suit.

Summary judgment for the defendants so moving is directed.

This shall be considered an order; settlement thereof is unnecessary.

So ordered.

APPENDIX B

Opinion of the Panel of the Court of Appeals

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Opinion of the Panel of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 160—September Term, 1967.

(Argued November 8, 1967 Decided May 29, 1968.)

Docket No. 31408

DAVID H. SCHOENBAUM,

Plaintiff-Appellant,

—against—

BRADSHAW D. FIRSTBROOK, *et al.*,

Defendants,

—and—

HAROLD W. MANLEY, LOUIS PRADAL, JOHN C. RUDOLPH, DONALD K. RUSSELL, AQUITAINE COMPANY OF CANADA, LTD. and PARIBAS CORPORATION OF NEW YORK,

Defendants-Appellees.

Before:

LUMBARD, *Chief Judge,*
MEDINA and HAYS, *Circuit Judges.*

Appeal from an order of the District Court for the Southern District of New York, Irving Ben Cooper, *J.*, granting summary judgment for defendants for failure to state a cause of action under Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. §18j(b), and Rule

10b-5, 17 CFR §240.10b-5 (1967). 268 F. Supp. 385 (S. D. N. Y. 1967).

Affirmed.

SIDNEY B. SILVERMAN, New York, N. Y., *for plaintiff-appellant.*

WHITNEY NORTH SEYMOUR, JR., New York, N. Y. (Simpson, Thacher & Bartlett and John C. Diller, New York, New York, on the brief), *for defendants Harold W. Manley, John C. Rudolph and Donald K. Russell.*

MICHAEL M. MANEY, New York, N. Y. (Sullivan & Cromwell and Marvin Schwartz, New York, N. Y. on the brief), *for defendants Aquitaine Company of Canada, Ltd. and Louis Pradal.*

DAVID HARTFIELD, JR., New York, N. Y. (White & Case, Thomas A. Butler and Paul J. Bschorr, New York, N. Y., on the brief), *for defendant Paribas Corporation.*

LUMBARD, *Chief Judge*:

Plaintiff, an American shareholder of Banff Oil Ltd., a Canadian corporation, brought this shareholder derivative action to recover under Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. 18j(b) and Rule 10b-5, 17 CFR §240.10b-5 (1967), for damages to the corporation resulting from the sales, in Canada, of Banff treasury stock to defendants Aquitaine of Canada, Ltd., and Paribas Corporation. Plaintiff alleged that the defendant corporations and Banff's directors, who are the individual de-

fendants in this action, conspired to defraud Banff by making Banff sell treasury shares at the market price which the defendants, who had inside information not yet disclosed to the public, knew did not represent the true value of the shares.

Defendants moved pursuant to Rules 12(c) and 56, Fed. R. Civ. P., for summary judgment, and under Rule 12(b) to dismiss the complaint on the ground that the Court lacked jurisdiction over the subject matter. Judge Cooper, refusing to permit plaintiff to carry out a program of discovery, entered judgment for defendants, holding that the Court lacked jurisdiction because the Securities and Exchange Act does not have extraterritorial application, and that plaintiff failed to state a cause of action under §10(b) and Rule 10b-5. 268 F. Supp. 385 (SDNY 1967).

We find that the district court had subject matter jurisdiction but affirm the judgment below because, while plaintiff's complaint alleges a breach of fiduciary duty by Banff's directors in authorizing sales of treasury shares at too low a price, these allegations fail to state a cause of action under §10(b) of the Exchange Act.

The Facts

Banff is a Canadian corporation and conducts all of its operations within Canada. Its common stock is registered with the SEC and traded upon both the American Stock Exchange and the Toronto Stock Exchange. In February 1964, Aquitaine Company of Canada, Ltd., acquired control of Banff through a tender offer to Banff shareholders in the United States and Canada. Aquitaine is a wholly owned subsidiary of a French corporation, Societe National des Petroles d'Aquitaine, which in turn is a subsidiary of Enterprises for Research and Activities in Petroleum (ERAP), a French governmental oil agency.

In March 1964, Banff and Aquitaine entered into an agreement to conduct joint oil explorations. In October 1964, Banff entered into a "farmout agreement" with Socony Mobil under which Banff and Aquitaine would receive a 50% interest in 160,000 acres in the Rainbow Lake area of Alberta, Canada, in return for paying the total cost of drilling two exploratory wells. The Rainbow area is a desolate wilderness region over 100 miles from the nearest all-weather road or railway. At least sixteen wells had previously been drilled in the general vicinity by six different oil companies, and all had been abandoned as failures. Because of the difficulty of conducting explorations in this region and the highly speculative prospects for success Socony Mobil was willing to give up a half interest merely for drilling two test wells.

Banff received a 5% interest and Aquitaine received a 45% interest, pursuant to their joint exploration agreement, with the drilling costs to be paid 10% by Banff and 90% by Aquitaine. On December 11, 1964 Banff's Board of Directors, the three Aquitaine representatives abstaining, voted to offer to sell 500,000 shares of Banff treasury stock to Aquitaine at the current market price allegedly for the purpose of financing Banff's share of the exploration expenses. On January 5, 1965, Aquitaine's president wrote to Banff that "our Chairman and Managing Director ... has agreed to your ... proposal." On January 26, Banff issued a press release announcing that Aquitaine "intended to purchase" 500,000 shares of common stock at the price of $1.35 per share, the closing price on the Toronto Stock Exchange on December 11, 1964. Actual delivery of the shares took place March 16, 1965.

Exploration in the Rainbow area commenced toward the end of 1964. On February 6, 1965, the test well flowed oil to the surface on a drillstem test. This information was

released to the public on February 8. The well reached total depth on March 17, 1965, the day after delivery on the Aquitaine purchase. On March 18, Banff issued a press release indicating that the discovery well was completed and that no further information would be disclosed in the immediate future. A further release on April 20 explained that the company was taking advantage of the Alberta law permitting it to withhold information on its discovery for one year to reduce competition from other companies in bidding on government oil lands in the discovery area. The release stated "The Board feels that this discovery is of great significance to the company but it is too early to have any idea of the areal extent."

After the discovery, further exploration activity was undertaken. In September 1965, a press release announced the formation of a company, in which Banff has a 3⅓% interest and Aquitaine has a 30% interest, to build a pipeline into the area. To finance its activities, Banff's Board of Directors authorized negotiation of sales of treasury shares of common stock at $6.75 per share or more. Paribas Corporation—a Delaware corporation doing business in New York and a wholly owned subsidiary of Banque de Paris et des Pays-Bas, a French banking institution—negotiated a purchase of 270,000 shares of Banff Common at $7.30 per share, the current price on the Toronto Stock Exchange, on behalf of Banque de Paris et des Pays-Bas pour le Grand Duche de Luxembourg, another subsidiary of Banque de Paris. The issue was to be placed with "ten European professional investors." A verbal offer was made by Paribas on November 19, 1965. A written offer was mailed by Paribas from New York and was accepted by Banff in Canada on November 22. Payment and delivery took place in Canada January 24, 1966.

The Allegations in the Complaint

The complaint alleged that "For some time prior to February 6, 1965, Aquitaine and the other defendants knew Banff had exceptionally valuable oil properties located in the Rainbow Lake area in Alberta, Canada." It alleged that the Aquitaine purchase of 500,000 treasury shares at $1.35 per share took place March 15, 1965, and that the Paribas purchase of 270,000 shares at $7.30 on January 24, 1966 was on behalf of "affiliates, business associates and friends" of Aquitaine and its parent companies, and that defendants withheld information until March 16, 1966 in order to purchase the treasury shares at an artificially low market price, paying to Banff about $10,000,000 less than the stock's fair market value.[1]

The individual defendants are all of Banff's directors. They allegedly conspired with the corporate defendants and approved of, participated in or acquiesced in the transactions with the corporate defendants.

Subject Matter Jurisdiction

Plaintiff predicated subject matter jurisdiction upon Section 27 of the Securities and Exchange Act, 15 U. S. C. §78aa, which gives the district courts exclusive jurisdiction over all "actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder." The district court concluded that the Act has no extraterritorial application, and that therefore no liability arose under the Act with regard to the sales in question, which took place in Canada between foreign buyers and sellers. The court found nothing to rebut the presumption that the Act was intended to apply only to transactions

1 Banff common stock traded at prices as high as $18 per share in 1966.

within the territorial limits of the United States. It also stated that the presumption was reinforced by the "specific mandate" of Section 30(b), 15 U. S. C. §78dd(b), which provides that the Act does not apply "to any person insofar as he transacts a business in securities without the jurisdiction of the United States . . ."

We disagree with the district court's conclusion. We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities. In our view, neither the usual presumption against extraterritorial application of legislation nor the specific language of Section 30(b) show Congressional intent to preclude application of the Exchange Act to transactions regarding stocks traded in the United States which are effected outside the United States, when extraterritorial application of the Act is necessary to protect American investors.

Section 2 of the Exchange Act, 15 U. S. C. §78b, states that because transactions in securities are affected with "a national public interest" it is "necessary to provide for regulation and control of such transactions and of practices necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce . . . and to insure the maintenance of fair and honest markets in such transactions."

The Act seeks to regulate the stock exchanges and the relationships of the investing public to corporations which invite public investment by listing on such exchanges. H. R. Rep. No. 1383, 73rd Cong., 2d Sess. (1934), reprinted in

78 Cong. Rec. 7702 (1934). See also statements of Rep. Lea, 78 Cong. Rec. 7861 and Rep. Mapes, 78 Cong. Rec. 7922.

Banff common stock is registered and traded on the American Stock Exchange. To protect United States shareholders of Banff common stock, Banff is required to comply with the provisions of the Securities Exchange Act concerning financial reports to the SEC, §13, 15 U. S. C. §78m; proxy solicitation, §14, 15 U. S. C. §78(n), and reports of insider holdings, §16, 15 U. S. C. §78(p). Similarly, the anti-fraud provision of §10(b), which enables the Commission to prescribe rules "necessary or appropriate in the public interest or for the protection of investors" reaches beyond the territorial limits of the United States and applies when a violation of the Rules is injurious to United States investors. "Acts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a State in punishing the cause of the harm as if [the actor] had been present at the [time of the detrimental] effect, if the State should succeed in getting him within its power." *Strassheim* v. *Dailey*, 221 U. S. 280, 285 (1911).

The Commission has recognized the broad extraterritorial applicability of the Act and has specifically exempted certain foreign issuers from the operation of Sections 14 and 16 of the Act, when enforcement would be impractical. Rule 3a12-3, 17 CFR 240, 3a12-3 (1967). The Commission has applied Section 15(a), 15 U. S. C. §78(o), to foreign broker-dealers who transact business through use of the mails. See Rule 17a-7, 17 CFR §240.17a (1967); 2 Loss, Securities Regulation, 1292 n. 15 (2d ed. 1961). Although it has the power to grant exemptions from rules under §10(b), see Rules 10b-6(d), 10b-7(n), 1 Loss, Securities Regulation, 799 n. 48 (2d ed. 1961), the Commission has

not promulgated a rule exempting foreign transactions from Rule 10b-5.[2]

The provision contained in Section 30(b) does not alter our conclusion that the Exchange Act has extraterritorial application. In our view, while section 30(b) was intended to exempt persons conducting a business in securities through foreign securities markets from the provisions of the Act, it does not preclude extraterritorial application of the Exchange Act to persons who engage in isolated foreign transactions.

Section 30, entitled "Foreign Securities Exchanges,"[3] deals with the extent to which the Act applies to persons effecting securities transactions through foreign exchanges. Section 30(a) empowers the SEC to regulate all brokers and dealers who use the mails or interstate commerce, for the purpose of effecting a transaction in American securities on exchanges outside the United States. 2 Loss, Securities Regulation, 1170 n. 2 (2d ed. 1961). It was

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2. However, a transaction conducted entirely outside of the United States would not violate §10(b) since the requisite use of interstate commerce or the mails would be lacking. See discussion *infra*.

3 "Section 30. (a) It shall be unlawful for any broker or dealer, directly or indirectly, to make use of the mails or of any means or instrumentality of interstate commerce for the purpose of effecting on an exchange not within or subject to the jurisdiction of the United States, any transaction in any security the issuer of which is a resident of or is organized under the laws of, or has its principal place of business in, a place within or subject to the jurisdiction of the United States, in contravention of such rules and regulations as the Commission may prescribe, as necessary or appropriate in the public interest or for the protection of investors or to prevent the evasion of this title.

(b) The provisions of this title or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this title."

intended to prevent evasion of the Act through transactions on foreign exchanges. See Hearings on S. Res. 89 (72d Cong.), and S. Res. 56 and S. Res. 97 (73d Cong.) before the Committee on Banking and Currency, 73d Cong., 2d Sess. part 15, pp. 6569, 6578-79 (1934).

Section 30(b) states that the Act does not apply in the absence of SEC rule to prevent evasion of the Act to "any person insofar as he transacts a business in securities without the jurisdiction of the United States." The language of §30(b) must be construed in light of the purpose of the subsection, and the definitions of terms contained in §3(a) of the Act.

The purpose of this subsection is to permit persons in the securities business to conduct transactions in securities outside of the United States without complying with the burdensome reporting requirement of the Act and without being subject to its regulatory provisions, except insofar as the Commission finds it necessary and appropriate to regulate such transactions to prevent evasion of the Act. It is also designed to take the Commission out of the business of regulating foreign security exchanges unless the Commission deems regulation necessary to prevent evasion of the domestic regulatory scheme.[4] The exemption relieves the Commission of the impossible task of enforcing American securities law upon persons whom it could not subject to the sanctions of the Act for actions upon which it could not bring its investigatory powers to bear.

If §30(b) had been meant to exempt every transaction by any person outside of the United States it would have been drafted to state that the Act does not apply to "any transaction in any security outside the jurisdiction of the United States," a phrase used in §30(a). The drafters used

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4 The SEC has not promulgated any rules or regulations under §30.

the phrase "any person insofar as he transacts a business in securities without the jurisdiction of the United States" in §30(b) because it is a term which would exempt the business transactions not only of brokers and dealers but also of banks. The term "brokers and dealers," used in §30(a), could not be used because the definitions of "broker" and "dealer" in §§3(a)(4) and 3(a)(5), 15 U. S. C. §§78(c)(a)(4) and (5), specifically exclude "banks" as defined in §3(a)(6), 15 U. S. C. §78(a)(6). It is precisely the terminology that appears in §30(b), when construed in light of §§3(a)(4) and (5) that exempts brokers and dealers and banks otherwise subject to the Act insofar as they conduct transactions not subject to §30(a) outside the United States, even though their United States transactions are subject to the Act.

In *Kook* v. *Crang,* 182 F. Supp. 388 (S. D. N. Y. 1960) the Court properly held that §30(b) exempted from the margin requirements of Section 7(c) of the Act, 15 U. S. C. §78q(c), sales to a United States citizen of Canadian stock in Canada by a Canadian broker, since the transactions were outside of the United States and part of the Canadian firm's business in securities. 2 Loss, Sec. Reg. 1292 n. 15 (2d ed. 1961). The Court found in §30(b) a Congressional intent to exempt from application of the Act transaction of a business in securities outside the United States.

This holding was extended in *Ferraioli* v. *Cantor,* CCH Fed. Sec. L. Rep. ¶91, 615 (S. D. N. Y. 1965) to exempt an isolated transaction, not part of a business in securities, the private sale in Canada of controlling shares of a New York corporation in which plaintiff was a minority shareholder, on the ground that the Exchange Act does not have extra-territorial application. The Court reasoned that if Congress specifically exempted foreign business in securities it

intended to exempt isolated transactions as well. We disagree with this reasoning.

We find that the language and purpose of §30(b) show that it was not meant to exempt transactions that are conducted outside the jurisdiction of the United States unless they are part of a "business in securities." Indeed, since Congress found it necessary to draft an exemptive provision for certain foreign transactions and gave the Commission power to make rules that would limit this exemption, the presumption must be that the Act was meant to apply to those foreign transactions not specifically exempted.

We hold that the district court has subject matter jurisdiction over violations of the Securities Exchange Act although the transactions which are alleged to violate the Act take place outside the United States, at least when the transactions involve stock registered and listed on a national securities exchange, are detrimental to the interests of American investors. See *Ford* v. *United States,* 273 U. S. 503, 619-624 (1927); *United States* v. *Pizzarusso,* —— F. 2d —— (2d Cir. Jan. 9, 1968); *United States* v. *Aluminum Company of America,* 148 F. 2d 416, 443-444 (2d Cir. 1945).

However, the district court found that the only harm alleged was to the foreign corporation on whose behalf plaintiff brought the action. We do not agree. A fraud upon a corporation which has the effect of depriving it of fair compensation for the issuance of its stock would necessarily have the effect of reducing the equity of the corporation's shareholders and this reduction in equity would be reflected in lower prices bid for the shares on the domestic stock market. This impairment of the value of American investments by sales by the issuer in a foreign

country, allegedly in violation of the Act, has in our view, a sufficiently serious effect upon United States commerce to warrant assertion of jurisdiction for the protection of American investors and consideration of the merits of plaintiff's claim.[5] *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 431-434 (1964). See *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F. 2d 540, 547 (2d Cir. 1967).

Summary Judgment

Since we conclude that the district court had subject matter jurisdiction we must go on to examine plaintiff's second claim: that defendants were not entitled to summary judgment under Rules 12(c) and 56. Fed. R. Civ. Pro. We agree with the trial court that on motion for summary judgment plaintiff's unsupported allegations based upon information and belief cannot be credited where they are contradicted by the affidavits on personal knowledge which defendants submitted in support of their motion. We further agree that on the record, plaintiff has shown at most a breach of fiduciary duty by Banff's directors and that this is insufficient to constitute a cause of action under §10(b) of the Exchange Act.

Under Rule 12(c), if affidavits are submitted to support a motion for judgment on the pleadings, the motion is treated as one for summary judgment and disposed of as provided by Rule 56. Rule 56(e) requires affidavits to be made on personal knowledge. It specifically states "When a motion for summary judgment is made and supported as

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5 However, if the wrong alleged also constitutes the basis for a cause of action under foreign law a district court might decline to exercise its jurisdiction under the doctrine of *forum non conveniens*. See *Vanity Fair Mills, Inc.* v. *T. Eaton Co.*, 234 F. 2d 633 (2d Cir.), cert. denied, 352 U. S. 871 (1956).

provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial."

Defendants submitted in support of their motion affidavits on the personal knowledge of the President of Banff Oil, the President of Aquitaine, and the Manager of the Industrial Division of Paribas, all of whom are directors of Banff as well. Plaintiff submitted an affidavit by its attorney stating that "the facts are set forth in plaintiff's memorandum of law and will not be repeated herein." On these papers, plus plaintiff's verified complaint, also on information and belief, summary judgment for defendants was granted. The trial court correctly ruled that when plaintiff failed to submit affidavits on personal knowledge in support of the complaint in opposition to defendants' affidavits on personal knowledge, factual issues were to be resolved against the plaintiff wherever defendants' affidavits conflict with the unsupported allegations of the complaint upon information and belief. E.g., *Automatic Radio Manufacturing Co., Inc.* v. *Hazeltine Research, Inc.*, 339 U. S. 827 (1950); *Union Insurance Society of Canton, Ltd.* v. *William Gluckin & Co.*, 352 F. 2d 947, 952 (2d Cir. 1965). 6 Moore, Federal Practice, ¶56.22[1] at 2803, 2806 (1965). Our statement of the facts at the beginning of the opinion is an application of this principle to the pleadings and motion papers.

Use of Interstate Commerce

There can be no violation under Section 10[6] unless a rule of the Commission is contravened "directly or indirectly,"

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6 "Section 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate

by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange. See generally 3 Loss, Sec. Reg. 1519-1524 (2d ed. 1961). The trial court found that the transactions in question were essentially Canadian, with insufficient contacts with the United States to fall within §10(b) of the Act. We are uncertain whether the Court's finding was directed at the issues of extraterritorial application of the Exchange Act or at the jurisdictional requirements of §10. In either case we disagree with its conclusion. We have already discussed the reasons why a foreign purchase or sale of treasury shares by a corporation has sufficient effect upon interstate commerce to warrant extraterritorial application of the Exchange Act.

The present question is not whether this limited use of the mails and the facilities of interstate commerce would be a sufficient basis for subject matter jurisdiction over a foreign transaction which would otherwise be exempt from the Act, see *Kook* v. *Crang, supra*, but whether, once it has been determined that the Act applies to a particular foreign transaction, there is a use of the mails or interstate commerce sufficient to meet the requirement of §10(b). We find that defendant's affidavits show a use of interstate commerce or the mails sufficient to bring both transactions within the scope of Section 10(b).

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commerce or of the mails, or of any facility of any national securities exchange— . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Since defendants admit that the Aquitaine purchase was delayed pending the successful conclusion of negotiations with the Treasury Department regarding tax rulings and negotiations with the American Stock Exchange regarding the listing of the additional shares, we find, on this record, that these negotiations were a part of the scheme for the sale of treasury stock to Aquitaine. And since it appears that, as plaintiff alleges, these negotiations with United States government and stock exchange officials must have made some use of the mails or other facilities of interstate commerce, there was at the very least use of interstate commerce[7] or the mails sufficient to bring the sales transactions within the scope of Section 10(b). *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195, 204 (5th Cir. 1960), cert. denied, 365 U. S. 814 (1961).

The Paribas transaction likewise involved negotiations which must have taken place in part in the United States or made some use of the mails or interstate commerce. Furthermore, the purchase agreement was mailed from Paribas in New York to Banff in Canada; this in itself would establish a use of the mails sufficient to meet the requirement of Section 10.

Rule 10b-5

Plaintiff's theory of its cause of action is that "Banff was defrauded by its directors and controlling shareholder who combined to force it to sell treasury shares at the prevailing market price when they knew that the price was an artificially low one." In other words, plaintiff contends that defendants violated §10(b) and Rule 10b-5 by causing

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7 The term "interstate commerce," as used in the Exchange Act, encompasses commerce "between any foreign country and any state." §3(a)(17), 15 U. S. C. §78c(a)(17).

Banff to issue shares to defendant corporations at the current market price at a time when all the defendants knew that Banff had made an oil discovery which, if known to the public, would have raised the market price considerably. For purposes of the motion the court below rejected plaintiff's claim of the existence of a conspiracy and defendants' claims that at the time of the transaction they did not have material information and assumed that at the time of the sales in question the buyers and Banff's directors all knew that Banff had made a valuable discovery. We agree with the district court's conclusion that plaintiff failed to state a cause of action under Rule 10b-5[8] because there was no fraud and the allegations amounted to nothing more than breach of fiduciary duty by the controlling shareholder and directors.

The district court properly treated Banff's sales as arm's length transactions since plaintiff failed to produce affidavits on personal knowledge to support his allegations of conspiracy among the defendants to contradict the defendants' affidavits which categorically denied the existence of any conspiracy, *Scolnick* v. *Lefkowitz*, 329 F. 2d 716 (2d Cir. 1964).

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8 "RULE 10b-5. EMPLOYMENT OF MANIPULATIVE AND DECEPTIVE DEVICES.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

We do not see how Banff's directors, in authorizing sales of treasury stock in arm's length transactions in which all parties possessed the same information, can properly be characterized as participating in a "manipulative or deceptive device or contrivance" in connection with a sale so as to fit within §10(b) merely because some shareholders now consider the sale price too low. Plaintiff's claim fails to state a cause of action under §10(b) because it does not show that the corporation was deceived. The directors, who were authorized to act on behalf of the corporation in these transactions, were all concededly in full possession of the material information, and we find no basis, on the facts before us, for refusing to impute their knowledge to the corporation.

A corporation can act only through its agents and officers and can know only what its agents and officers know. *Bergeson* v. *Life Insurance Corporation of America,* 265 F. 2d 227, 232 (10th Cir.), cert. denied, 360 U. S. 932 (1959); *City of Philadelphia* v. *Westinghouse Electric Corporation,* 205 F. Supp. 830, 831 (E. D. Pa. 1962); Ballantine on Corporations (Rev. Ed. 1946) §61, pp. 152-155; 19 C. J. S., Corporations §1078, p. 613; Restatement (Second) of Agency §9(3) (1957). If the persons entitled in the ordinary course to participate in authorizing a securities transaction on behalf of the corporation have not been fully informed, it may be said that the corporation has not been fully informed. *Ruckle* v. *Roto American Corp.,* 339 F. 2d 24 (2d Cir. 1964). In general, if the corporation's agents have not been deceived, neither has the corporation. However, as in other situations governed by agency principles, knowledge of the corporation's officers and agents is not imputed to it when there is a conflict between the interests of the officers and agents

and the interests of the corporate principal. *Monier* v. *Guaranty Trust Co. of New York*, 82 F. 2d 252, 254 (2d Cir.), cert. denied, 298 U. S. 670 (1936); *Maryland Casualty Co.* v. *Tulsa Industrial Loan & Investment Co.*, 83 F. 2d 14, 16-17 (10th Cir. 1936); *Ohio Millers' Mutual Insurance Co.* v. *Artesia State Bank*, 39 F. 2d 400, 402 (5th Cir. 1930); Ballantine on Corporations, *supra*; 19 C. J. S., Corporations §1084; Restatement (Second) of Agency §282(1) (1958). See *Ruckle* v. *Roto American Corp.*, 339 F. 2d at 29. Therefore, a corporation may be defrauded in a stock transaction even when all of its directors know all of the material facts, if the conflict between the interests of one or more of the directors and the interests of the corporation prevents effective transmission of material information to the corporation, in violation of Rule 10b-5(2).[9] See *O'Neill* v. *Maytag*, 339 F. 2d at 767.

While the purchaser in the Aquitaine transaction had three representatives on Banff's board of directors and was Banff's controlling shareholder, the Aquitaine representatives on the Banff board abstained from the authorization vote and shareholder ratification by Aquitaine was not required for the sale. Under these circumstances, we cannot refuse to impute the directors' knowledge to the corporation on the ground that directors participating in the corporate decision had a conflicting personal interest in the transaction. Compare *Pappas* v. *Moss*, Nos. 16405-

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.9 It is recognized that in many circumstances the knowledge of some of the members of the board of directors is not by itself sufficient to charge the corporation with knowledge. *Ruckle* v. *Roto American Corp.*, *supra*; *Ohio Millers' Mutual Insurance Co.* v. *Artesia State Bank*, 39 F. 2d at 403; *First National Bank* v. *Carroll*, 46 N. D. 62, 179 N. W. 664 (1920); *Reynolds* v. *Third National Bank*, 225 S. W. 901 (Mo. 1920); *Weissman* v. *A. Weissman, Inc.*, 374 Pa. 470, 97 A. 2d 870 (1953); *Hudson* v. *Alaska Airlines, Inc.*, 43 Wash. 2d 71, 260 P. 2d 321 (1953); Ballantine on Corporations, *supra*; 19 C. J. S., Corporations §1079(b).

16411 (3d Cir., April 9, 1968). Since the directors were all fully informed and since only the non-interested directors participated in the vote authorizing the sale, there is no deception of the corporation and no violation of §10(b) and Rule 10b-5 even though it may be that the directors, by authorizing sales of shares for inadequate consideration, may have breached their fiduciary duty to the corporation.

Section 10(b) does not encompass all corporate wrongs involving securities transactions. *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F. 2d 540, 545-46 (2d Cir. 1967); *O'Neill* v. *Maytag*, 339 F. 2d at 768; *Hoover* v. *Allen*, 241 F. Supp. 213, 226-29 (S. D. N. Y. 1965); *Caroliner* v. *Fair Lanes, Inc.*, 244 F. Supp. at 30. To the extent that Section 10(b) and Rule 10b-5 make conduct unlawful, the courts have implied a civil remedy for those damaged by the violation who are members of the class for whose benefit the statute was enacted. *Fischman* v. *Raytheon Manufacturing Co.*, 188 F. 2d 783, 787 (2d Cir. 1951). See cases cited *id.* at 787 n. 4.

The purpose of §10(b) is to enable buyers and sellers to make a "proper appraisal of the value of securities," §2(3)(b) and prevent manipulation and control of prices which would cause excessive speculation. §2(3). See *A. T. Brod & Co.* v. *Perlow*, 375 F. 2d 393, 397 (2d Cir. 1967). In order to accomplish this purpose, the courts have held that "those persons engaged in buying and selling and trading" have an implied civil cause of action for violations of §10(b) and Rule 10b-5. *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d at 202. However, the purposes of the Securities Exchange Act, and more particularly, §10(b), would normally not be furthered by permitting persons on whose behalf others buy, sell and trade to

bring actions under §10(b) against their agents. For example, the beneficiary of a trust agreement does not have an implied civil cause of action under §10(b) and Rule 10b-5 against a trustee who, with full knowledge of all material information, sells shares from the trust corpus in an arm's length transaction for what the beneficiary considers to be inadequate consideration. If the trustee made a poor decision after considering the material information, the beneficiary's loss is not of the sort which §10(b) was meant to prevent and even though a literal interpretation of the language in Rule 10b-5 could cover the trustee's acts, the beneficiary is not entitled to bring a civil action in reliance upon §10(b)'s criminal liabilities.

Similarly, while a corporation would be entitled to protection under §10(b) when material misrepresentations are made in a securities transaction to those acting as its agents, §10(b) does not protect shareholders from directors who sell shares from the corporate treasury to third parties in arm's length transactions for consideration which the shareholders consider inadequate. The corporation received the protection to which it was entitled under the Act because the persons authorized to carry out the transaction on behalf of the corporation were in no way deceived, and there is no reason why their knowledge is not attributed to the corporation.

Nevertheless appellant argues that it would be anomalous to hold that no fraud or deception was practiced upon Banff within §10(b) because all of its directors had material information when in situations where only some of the directors had material information the corporation can recover under §10(b) and Rule 10b-5. This argument is beside the point because, as we have shown, the crucial question is not how many directors share the material

information, but whether or not their knowledge is imputed to the corporation. We think that it would be a greater anomaly to hold that the corporation is defrauded within the meaning of §10(b) when its shares are sold under circumstances in which the directors authorizing the sale could not have recovered under §10(b) if they had sold their own shares, when plaintiff has failed to show any reason why the directors' knowledge cannot be imputed to the corporation. If the corporation's investment judgment has not been impaired, because those authorized to act on its behalf were not deceived and all material information has imparted to the corporation through them, provision of a remedy under §10(b) for the wrong alleged would not be consonant with the purpose of this section of the Act. See *Ruckle* v. *Roto American Corp.*, 339 F. 2d at 29; *O'Neill* v. *Maytag*, 339 F. 2d at 767-768; *Hoover* v. *Allen*, 241 F. Supp. at 228. We have not departed from the view we expressed in *Ruckle* that the majority, or even the entire board of directors may be held to have participated in a scheme to defraud their corporation in violation of Rule 10b-5. See *O'Neill* v. *Maytag*, 339 F. 2d 764, 768 (2d Cir. 1964). In cases where it is alleged that the corporation's investment judgment has been impaired, either because some or all of those entitled to vote in the ordinary course upon the purchase or sale have been deceived, *Ruckle* v. *Roto American Corp., supra,* or because some or all of those who purchased shares from or sold shares to the corporation participated in the corporate decision, *Pappas* v. *Moss,* Nos. 16405-16411 (3d Cir., April 9, 1968); *Kane* v. *Central American Mining & Oil, Inc.*, 235 F. Supp. 559 (SDNY 1964), the corporation may bring an action under §10(b) and Rule 10b-5. See Fleischer, "Federal Corporation Law": An Assessment,

78 Harv. L. Rev. 1146, 1160-1167 (1965); Note, 18 Stan. L. Rev. 1339, 1342-1343 (1966).

Plaintiff has failed to make the necessary showing that those authorized to act on behalf of the corporation were deceived or that their knowledge should not be deemed the corporation's knowledge. There is no allegation that either of the purchasers had information not known to Banff's representatives or that they were guilty of deception or failure to disclose material information. The district court properly concluded that in these arm's length transactions in which all parties possessed the same information,[10] plaintiff failed to state a cause of action against either purchaser under Rule 10b-5. *Ruckle* v. *Roto American Corp., supra; Carliner* v. *Fair Lanes, Inc.*, 244 F. Supp. at 29.

Since there is no reason to believe that plaintiff could recast his complaint to meet the requirements of the statute through the use of discovery, we need not decide whether the district court abused its discretion in refusing plaintiff's request for discovery before granting summary judgment.

The judgment is affirmed.

HAYS, *Circuit Judge* (concurring in part and dissenting in part):

I concur in Judge Lumbard's distinguished opinion on the issue of jurisdiction.

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10 Appellant does not contend that failure to disclose to the public the information available to the directors concerning Banff's exploration activities was a violation of the securities laws or a breach of fiduciary duty. It is conceded that under Alberta law Banff was permitted to withhold detailed information for one year after completion of exploratory drilling on Crown reservations land.

I am constrained to dissent on the point of the applicability to the facts of this case of the provisions of Section 10(b) and, more particularly, Rule 10b-5.

Defendants are alleged to have caused Banff to sell treasury shares at a price far below the fair price of such shares. In doing so defendants took advantage of their special relationship to Banff by reason of which they knew of Banff's discovery of extremely valuable oil reserves,—information which was clearly material to the purchase of the securities.

The complaint alleges a scheme to defraud the corporation by transferring corporate property to the corporation's majority stockholder and to an affiliate of the majority stockholder for a vastly inadequate consideration. My brothers do not absolve the defendants of fraud by calling their action a breach of fiduciary duty. There is no reason for making that distinction since such a breach of fiduciary duty as is here alleged clearly constitutes fraud.

The majority "cannot see how Banff's directors . . . can properly be characterized as participating in a 'manipulative or deceptive device or contrivance' in connection with a sale so as to fit within §10(b) merely because some shareholders now consider the sale price too low." This statement completely disregards allegations of the complaint which are based upon matters of record and which establish that the treasury stock was sold at a price which did not reflect in any way the value of the recently discovered oil reserves. Whatever reason there may be for denying plaintiffs' recovery in this case it certainly cannot be because their complaint is deficient in its allegation that Banff was bilked of some millions of dollars by the transactions in question.

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1 See Note 8 *supra*.

Rule 10b-5[1] makes it unlawful for any person

"(1) to employ any device, scheme, or artifice to defraud" or

"(3) to engage in any act, practice, or course of business which operates . . . as a fraud . . . upon any person, in connection with the purchase or sale of any security."

The acts in which defendants are alleged to have engaged clearly fall within the literal language of both of these subdivisions of Rule 10b-5.

The purpose of Section 10(b) and Rule 10b-5 is apparent from their language. That purpose is simply to prevent in interstate commerce the perpetration of fraud in connection with the sale of securities.

"Quite obviously the broad purpose of this legislation was to keep the channels of interstate commerce, the mail, and national security exchanges pure from fraudulent schemes, tricks, devices, and all forms of manipulation." *Hooper* v. *Mountain States Securities Corporation,* 282 F. 2d 195, 202 (5th Cir. 1960), cert. denied, 365 U. S. 814 (1961).

Reluctance to see the federal courts involved in this broad field cannot justify rejection of a case that comes so clearly within the ambit of the statute as does the case which we are now considering.

The majority believe that the complaint fails to "state a cause of action under §10(b) because it does not show that the corporation was deceived" since the directors "who were authorized to act on behalf of the corporation in these transactions were all concededly in full possession of the material information" and the knowledge of the directors is to be "imputed to the corporation."

Endowing a corporation with a fictitious "personality," so that, for example, it has "knowledge," is a useful device

for the analysis of many problems. But it can also constitute a trap for the unwary when they ascribe reality to the fictions. What the majority is actually saying is that since the directors *were* the corporation for the purposes of the questioned transactions the corporation must have known what the directors knew, or, in other words, the directors knew what the directors knew. There is, of course, no justification for interposing the corporate fiction between the directors and the minority stockholders who were the victims of the directors' fraudulent actions. In order to establish fraud it is surely not necessary to show that the directors deceived themselves. It must be enough to show that they deceived the shareholders, the real owners of the property with which the directors were dealing. Deception of the shareholders (with the exception of the majority stockholder which was a party to the transactions) is established by showing that the directors withheld from them information that would have revealed the true value of the treasury stock.

The directors cannot take refuge behind the law permitting the information as to the discovery of the reserves to be withheld for one year. Such a law does not constitute a license to the directors to deal with the property as if no such discovery had been made. To argue to the contrary would be to argue that the directors could give the oil reserves away, as they in fact did in part, by selling the treasury stock at a price which did not reflect the value of the reserves.

What we have here then is a scheme by which the directors of Banff gave to the controlling stockholder[2] and an

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2 The abstention of the "Aquitaine directors" on the vote for the sale to Aquitaine is hardly worthy of mention. As I said in my dissenting opinion in *Alleghany Corporation* v. *Kirby*, 344 F. 2d 571

affiliated corporation some millions of dollars worth of the corporation's property. A plainer case of fraud would be hard to find.

(2d Cir. 1965), cert. dismissed as improvidently granted, 384 U. S. 28 (1966):

> "No one who knows anything about the conduct of corporate enterprise considers that the major stockholder's withdrawal from the room when a vote is taken amounts to anything more than an empty ceremonial."

APPENDIX C

Opinion of the Court of Appeals *en banc*

APPENDIX C

Opinion of the Court of Appeals *en banc*

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 160—September Term, 1967.

(Argued November 8, 1967

—Decided by a three-judge panel May 29, 1968—

Submitted to the *en banc* court July 31, 1968

Decided December 30, 1968.)

Docket No. 31408

DAVID H. SCHOENBAUM,

Plaintiff-Appellant,

—v.—

BRADSHAW D. FIRSTBROOK, *et al.*,

Defendants,

—and—

HAROLD W. MANLEY, LOUIS PRADAL, JOHN C. RUDOLPH, DONALD K. RUSSELL, AQUITAINE COMPANY OF CANADA, LTD., and PARIBAS CORPORATION OF NEW YORK,

Defendants-Appellees.

Before:

LUMBARD, *Chief Judge,* MEDINA, *Senior Circuit Judge,** WATERMAN, MOORE, FRIENDLY, SMITH, KAUFMAN, HAYS, ANDERSON and FEINBERG, *Circuit Judges.*

* Sitting pursuant to 28 U. S. C. §46(c) (1964).

Appeal from an order of the United States District Court for the Southern District of New York, Irving Ben Cooper, *Judge,* granting summary judgment to defendants on the ground that the complaint failed to state a claim on which relief could be granted under Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. §78j(b) and Rule 10b-5, 17 C. F. R. §240.10b-5 (1968). 268 F. Supp. 385 (S. D. N. Y. 1967).

Affirmed as to defendant Paribas Corporation; reversed as to the other defendants.

SIDNEY B. SILVERMAN, New York, New York, *for Appellant.*

WHITNEY NORTH SEYMOUR, JR., New York, New York (Simpson, Thacher & Bartlett, and John C. Diller, New York, New York, on the brief), *for Appellees Manley, Rudolph and Russell.*

MICHAEL M. MANEY, New York, New York (Sullivan & Cromwell and Marvin Schwartz, New York, New York, on the brief), *for Appellees Aquitaine Company of Canada, Ltd., and Pradal.*

DAVID HARTFIELD, JR., New York, New York (White & Case, Thomas A. Butler and Paul J. Bschorr, New York, New York, on the brief), *for Appellee Paribas Corporation.*

HAYS, *Circuit Judge*:

After a panel opinion in this case was issued a petition for rehearing *en banc* was granted. Additional briefs were

submitted including an *amicus* brief by the Securities and Exchange Commission. On consideration by the full court the order of the district court granting summary judgment for the defendants is affirmed as to the defendant Paribas Corporation and reversed as to the other defendants.

The petition for rehearing sought reconsideration only of the issue of whether the defendants were entitled to summary judgment under Rules 12(c) and 56 of the Federal Rules of Civil Procedure. The court *en banc* has not reviewed the decision announced by Chief Judge Lumbard on the issue of jurisdiction over the subject matter and that decision stands as the holding of the court.

Factual Background of the Controversy

This is a stockholder's derivative action on behalf of Banff Oil Ltd., a Canadian corporation. The corporate defendants are Aquitaine Company of Canada, Ltd., and Paribas Corporation. The individual defendants are directors of Banff. Aquitaine is a wholly owned subsidiary of a French corporation, Société National des Petroles d'Aquitaine, which is in turn a subsidiary of an agency of the French government. Paribas is an investment banking corporation, incorporated in Delaware. It is a wholly owned subsidiary of a French banking institution.

In February, 1964, Aquitaine acquired control of Banff through a tender offer to Banff shareholders. Aquitaine thereupon designated three of its representatives to sit on Banff's eight man board of directors.

In March, 1964, Banff and Aquitaine agreed to conduct joint explorations for oil. The exploratory operations involved in the present case began toward the end of 1964. A test well struck oil on February 6, 1965 and on March 17, 1965 the well was completed.

On December 11, 1964, Banff's board of directors voted to offer 500,000 shares of Banff treasury stock to Aquitaine, its controlling shareholder, at $1.35 a share. The closing price of Banff stock on the Toronto Stock Exchange on that day was $1.31 bid and $1.37 asked. Aquitaine claims that the sale of stock was necessary in order to finance Banff's share of the expenses of exploration. However it appears that Banff needed only $77,500 for this purpose, whereas the proceeds of the sale amounted to $675,000. On January 5, 1965, the president of Aquitaine wrote to Banff "on behalf of Aquitaine's members of Banff Oil Board" saying "our Chairman and Managing Director . . . has agreed to your . . . proposal." The shares were delivered to Aquitaine on March 16, 1965, the day before the completion of the first well.

In November 1965 Paribas negotiated a purchase of 270,000 shares of Banff stock at $7.30 a share, the then current price on the Toronto Stock Exchange.

During 1966, after public announcement of the oil discovery, Banff stock traded at prices as high as $18 a share.

The complaint alleges, in effect, that the defendants, knowing of the oil discoveries and the consequent increase in value of Banff stock, sold 770,000 shares of that stock to Aquitaine and Paribas at vastly inadequate prices as a result of a conspiracy among them to enrich Aquitaine's "affiliates, business associates and friends" at the expense of Banff and its shareholders other than Aquitaine.

Summary Judgment

The district court's grant of summary judgment against the plaintiff was accompanied by a refusal of his request for discovery. This court has indicated that summary judgment should rarely be granted against a plaintiff in a

stockholder's derivative action especially when the plaintiff has not had an opportunity to resort to discovery procedures. See, for example, *Subin* v. *Goldsmith,* 224 F. 2d 753 (2d Cir.), cert. denied, 350 U. S. 883 (1955); *Colby* v. *Klune,* 178 F. 2d 872 (2d Cir. 1949); *Fogelson* v. *American Woolen Co.,* 170 F. 2d 660 (2d Cir. 1948). The plaintiff typically has in his possession only the facts which he alleges in his complaint. Having little or no familiarity with the internal affairs of the corporation, he is faced with affidavits setting forth in great detail management's version of what actions were taken and what motives led the affiants to take these actions. Since the facts in such a case are exclusively in the possession of the defendants, summary judgment should not ordinarily be granted where the facts alleged by the plaintiff provide a ground for recovery, at least not without allowing discovery in order to provide plaintiff the possibility of counteracting the effect of defendants' affidavits.

Indeed in many stockholder's derivative actions there will be issues as to the knowledge, intent and motive which will require a full trial with an opportunity to observe the demeanor of the witnesses, and to conduct cross-examination in open court. In such cases summary judgment cannot be granted even after discovery has been had. See *Subin* v. *Goldsmith, supra,* at 757. See also *Poller* v. *CBS,* 368 U. S. 464, 473 (1962). ("We believe that summary procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles, the proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot."); *Cross* v. *United States,* 336 F. 2d 431, 434 (2d Cir. 1964); *Alvado* v. *General Motors Corp.,* 229 F. 2d 408, 411-12 (2d Cir. 1955), cert. denied, 351 U. S. 983 (1956). (For a discussion of a

number of additional cases, see Judge Frank's opinion in the *Subin* case.)

In the present case the plaintiff's allegations constitute a claim that Aquitaine, knowing the true value of Banff stock, used its control over Banff to acquire 500,000 shares at a vastly inadequate price. The allegations have a sufficient factual basis—Aquitaine's control, Aquitaine's knowledge of the oil discovery, the inadequacy of the price paid for the stock—to require at least that the plaintiff be permitted through discovery to develop the evidence to counter defendants' affidavits.

Plaintiff's Cause of Action Under Section 10-b and Rule 10b-5 of the Securities Exchange Act of 1934

We hold that the complaint states a triable claim under Section 10(b)[1] and Rule 10b-5[2] of the Securities Exchange Act of 1934 against all defendants except Paribas.

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1 REGULATION OF THE USE OF MANIPULATIVE AND DECEPTIVE DEVICES

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

2 EMPLOYMENT OF MANIPULATIVE AND DECEPTIVE DEVICES

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

As to Paribas it appears that the negotiations for the purchase of treasury stock were arm's length negotiations. There is no reason to believe that Paribas was in possession of any information not available to Banff and, more importantly, there is no reason to believe that Paribas was in any position to influence the judgment of the Banff directors by any improper means. Paribas and the purchasers whom it represented were, so far as appears, unconnected with Banff and unable through ownership of Banff stock or otherwise to bring any pressure on Banff to sell its stock at a price below its true value. For these reasons the dismissal of the complaint as to Paribas is affirmed.

The case against the other defendants is a far different one.

The issuance by Banff of its stock to Aquitaine was a sale of securities within the meaning of Section 10(b) and Rule 10b-5. The stockholders of Banff may bring a derivative action for damages to the corporation suffered by reason of a violation of Section 10(b) and Rule 10b-5. *Ruckle* v. *Roto Amer. Corp.*, 339 F. 2d 24 (2d Cir. 1964); *Hooper* v. *Mountain States Sec. Corp.*, 282 F. 2d 195 (5th Cir. 1960), cert. denied, 365 U. S. 814 (1961).

In *Ruckle* v. *Roto Amer. Corp., supra*, the corporation proposed to issue shares for an inadequate consideration. The new shares were to be issued to or, at least, to be controlled by the president of the corporation. Certain material information was withheld from one of the directors when the board was called upon to approve the transaction. The issuance of the shares under these circumstances was

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(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

held to be a fraud upon the corporation within the meaning of Section 10(b) and Rule 10b-5. The court said: "in other contexts, such as embezzlement and conflict of interest, a majority or even the entire board of directors may be held to have defrauded their corporation." 339 F. 2d at 29.

In the present case it is alleged that Aquitaine exercised a controlling influence over the issuance to it of treasury stock of Banff for a wholly inadequate consideration. If it is established that the transaction took place as alleged it constituted a violation of Rule 10b-5, subdivision (3) because Aquitaine engaged in an "act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." Moreover, Aquitaine and the directors of Banff were guilty of deceiving the stockholders of Banff (other than Aquitaine). See *Pappas* v. *Moss,* 393 F. 2d 865 (3d Cir. 1968).

It is argued that the agreement to sell Banff stock to Aquitaine was entered into before the results of the oil exploration were known. However it is by no means clear that the letter of Aquitaine's president dated January 5, 1965 resulted in the formation of a binding contract. Moreover in the absence of an opportunity for discovery procedures it cannot be accepted as true that on January 5, 1964 or at the earlier date in December, 1964 when Banff made the offer to sell, the parties were not in possession of sufficient information as to the true value of Banff stock to make the sale at market price a fraud on Banff. In addition, whether Aquitaine's acquisition of the Banff stock on the eve of the completion of the first oil well constituted overreaching presents an issue to be resolved only after an opportunity for further investigation.

The order of the district court is reversed as to all defendants except Paribas and the case is remanded for further proceedings consistent with this opinion.

MEDINA, *Circuit Judge* (dissenting, with whom LUMBARD, *Chief Judge,* and MOORE, *Circuit Judge,* concur):

I dissent and adhere to the views expressed in the majority panel opinion of Chief Judge Lumbard to the effect that, even assuming the contracting parties were possessed of information concerning the oil discovery at the time of the making of the contract to sell to Aquitaine, plaintiff did not make out a case under Rule 10(b)5.

The essence of the claim is that, whenever a corporation through action of its directors sells a block of its own stock, a stockholder can maintain an action in the federal courts under Section 10(b) and Rule 10(b)5 by merely alleging that the price was too low or too high, that the directors "knew or should have known" it was too low or too high, sealed with the characterization or opinion of the claimant that this was a "fraud" perpetrated against the corporation. This does indeed open the floodgates. For the result is to transform a simple cause of action against directors for waste or the use of bad judgment in the sale of corporate assets into a federal securities fraud case by judicial fiat. In my opinion the Congress never intended the Securities Exchange Act of 1934 to be interpreted so broadly as this.

We proceeded in the panel opinion upon the assumption that both parties to the transaction of purchase and sale of the Banff treasury stock knew Banff had struck oil because Judge Cooper proceeded upon the same hypothesis. In retrospect it is now apparent that it was a mistake to have made this contrary-to-fact assumption,

as it has thrown the whole case out of focus. Accordingly, and in the light of the views expressed in the majority *en banc* opinion of Judge Hays, it becomes essential to make a more complete statement of the factual background and the issues as framed in the complaint.

Confining the discussion to the Aquitaine transaction, as I concur in the disposition of the Paribas charge by the majority, the plaintiff's claim against Aquitaine and the Banff directors as defendants is that at the time of the sale of the Banff treasury stock to Aquitaine the defendants knew that Banff had made a rich strike of oil, that the true extent of the discovery was withheld for about a year so the defendants could make the sale to Aquitaine at a grossly inadequate price "to enrich themselves, business associates, friends and relatives," in order to depress the value of Banff stock on the American Stock Exchange and to maintain the price of the stock at an artificially low level.

What is established without a shred of countervailing proof by the summary judgment affidavits on personal knowledge filed by defendants is that the sale was authorized by the Banff directors on December 11, 1964, the offer was accepted in writing by Aquitaine on January 5, 1965, the drilling did not even commence until January 11, 1965 and the first flush of oil appeared on February 6, 1965. The transaction of purchase and sale of the stock was consummated on March 16, 1965, after a short delay caused by tax problems and compliance with the regulations of the American and Toronto Stock Exchanges. These are cold facts supported by documentary proof. The charge of enriching the individual defendants and their business associates, friends and relatives turned out to be just another stab in the dark, as did a similar charge

made in the complaint with respect to the Paribas transaction. And thus it now appears that the action taken by the Banff directors and the making of the ensuing contract took place at a time when there was no "inside information" about a rich oil strike and when there was no person anywhere who could know that the first drilling or any drilling in the Rainbow area in the future would be successful.

Moreover, information concerning the discovery of oil on February 6, 1965 was released to the public on February 8. On March 18, 1965, after the drilling of the first well was completed on March 17, a further press release was issued stating that no further information would be disclosed in the immediate future; and on April 20 an additional press release announced to the public that the company was taking advantage of the Alberta law permitting it to withhold information concerning its discovery for one year to reduce competition from other companies in bidding on government oil lands in the discovery area. Later other wells were drilled and extensive purchases were made of millions of acres of land in the vicinity and in other places in Canada where it was hoped similar subsurface conformations existed. Even plaintiff does not suggest that the public or the shareholders of Banff should have been informed of these developments, as such disclosure would have deprived Banff of the undoubted benefits conferred by the Alberta law.

What the case thus boils down to is the fact that Aquitaine owned a controlling interest in Banff. And because of this circumstance the majority holds that full discovery proceedings should be permitted to probe the minds of the defendants and lay bare their "motives," because plaintiff has "little or no familiarity with the internal affairs of the corporation."

What this amounts to is giving *carte blanche* to every holder of a few shares in any corporation whose stock is traded on the New York or American stock exchanges to give his imagination full rein in the making of any sort of extravagant charges, no matter how ill founded in fact they may be, and then, when faced with a summary judgment motion based upon personal knowledge and documentary proof, say simply "I know nothing whatever about the matter but hope my lawyer will find something if we conduct extensive discovery proceedings and compel the defendants to produce their complete files." This, while doubtless not so intended, is in my judgment nothing short of a standing invitation to blackmail and extortion. It is perfectly apparent that the expense of such discovery proceedings to the defendants, especially when they are foreigners as in this case, will be enormous; and a plaintiff and his lawyer under these circumstances would seem to have some justification for hoping they will be bought off in one way or another, despite the falsity of the allegations in the complaint. And all this under the aegis of Rule 10(b)5! This does not seem to be a very practical way of reducing congestion in the federal courts.

Accordingly, I would affirm the judgment appealed from in its entirety.

APPENDIX D

Judgment of the Court of Appeals

APPENDIX D

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the thirtieth day of December one thousand nine hundred and sixty-eight.

Present:

HON. J. EDWARD LUMBARD,
Chief Judge,

HON. HAROLD R. MEDINA,
HON. STERRY R. WATERMAN,
HON. LEONARD P. MOORE,
HON. HENRY J. FRIENDLY,
HON. J. JOSEPH SMITH,
HON. IRVING R. KAUFMAN,
HON. PAUL R. HAYS,
HON. ROBERT P. ANDERSON,
HON. WILFRED FEINBERG,
Circuit Judges.

DAVID H. SCHOENBAUM,
Plaintiff-Appellant,

v.

BRADSHAW D. FIRSTBROOK, et al.,
Defendants,

HAROLD W. MANLEY, LOUIS PRADAL, JOHN C. RUDOLPH, DONALD K. RUSSELL, AQUITAINE COMPANY OF CANADA, LTD., and PARIBAS CORPORATION OF NEW YORK,
Defendants-Appellees.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order and judgment of said District Court be and they hereby are reversed as to all appellees except Paribas Corporation of New York and as to it such order and judgment be and they hereby are affirmed and that the action be and it hereby is remanded to said District Court for further proceedings consistent with the opinion of this court with costs to be taxed against the plaintiff-appellant in favor of Paribas Corporation of New York and against the appellees in favor of David H. Schoenbaum.

A. DANIEL FUSARO
Clerk

APPENDIX E

Statutes and Rules Involved

APPENDIX E

Statutes and Rules Involved

The following statutes and rules are involved in this case:

Section 27 of the Securities Exchange Act of 1934, 48 Stat. 902, as amended, 15 U.S.C. § 78aa (1964), provides, in pertinent part:

> "The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. . . ."

Section 30(b) of the Securities Exchange Act of 1934, 48 Stat. 904, 15 U.S.C. § 78dd(b) (1964), provides:

> "(b) The provisions of this chapter or of any rule or regulation thereunder shall not apply to any person

insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter."

Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j(b) (1964), provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

S.E.C. Rule 10b-5 (17 CFR § 240.10b-5 (1968)) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in

order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Rule 56(e) of the Federal Rules of Civil Procedure provides:

"(e) Form of Affidavits; Further Testimony; Defense Required. Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him."

SUPREME COURT, U. S.

APR 30 1969

JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1968

No. 1215

HAROLD W. MANLEY, LOUIS PRADAL, JOHN C. RUDOLPH, DONALD K. RUSSELL and AQUITAINE COMPANY OF CANADA LTD.,

Petitioners,

against

DAVID H. SCHOENBAUM,

Respondent.

BRIEF FOR PLAINTIFF-RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI

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TABLE OF CONTENTS

	PAGE
Questions Presented	1
Statement of Facts	2
A. The Parties	2
B. Banff's Exploration Activities	3
C. The Aquitaine Purchase of Treasury Stock	4
D. Prior Proceedings	5
Reasons for Denying the Petition	6
I.—An Interlocutory Order Should Not Be Reviewed, Except Under Exceptional Circumstances Not Present in This Case	6
II.—The Exchange Act Can Have Extra-Territorial Application	7
III.—The District Court Has Jurisdiction to Determine the Violation Alleged	10
a) The mails and facilities of a national securities exchange were admittedly used	10
b) Fraud and deception are present whenever a fiduciary over-reaches in a trade with his *cestui que* trust	10
Conclusion	11

Table of Authorities

Cases:

American Construction Co. v. *Jacksonville Tampa and Key West Railway Co.*, 148 U. S. 372 (1893)	6
Di Bella v. *United States*, 369 U. S. 121 (1962)	6
Durland v. *United States*, 161 U. S. 306 (1896)	10

PAGE

Ford v. *United States*, 273 U. S. 593 (1927) 8

Kennedy v. *Silas Mason Co.*, 334 U. S. 249 (1948) 11

Poller v. *Columbia Broadcasting System, Inc.*, 368 U. S. 464 (1962) 11

Securities and Exchange Commission v. *Capital Gains Research Bureau*, 375 U. S. 180 (1963) 8, 10

Strassheim v. *Dailey*, 221 U. S. 280 (1911) 8

Tcherepnin v. *Knight*, 389 U. S. 332 (1967) 8

United States v. *Aluminum Co. of America*, 148 F. 2d 416 (2d Cir., 1945) 8

United States v. *Beatty*, 232 U. S. 463 (1914) 6

United States v. *Pizzarusso*, 388 F. 2d 8 (2d Cir., 1968) 8

Statutes and Rules

Securities Exchange Act of 1934:

Section 2, 15 U. S. C. §78b 7

Section 3(a)(17), 15 U. S. C. §78c(a)(17) 7

Section 10(b), 15 U. S. C. §78j(b) 10

Section 30(b), 15 U. S. C. §78dd(b) 9

Other Authorities

S. Rep. No. 379, 88th Cong., 1st Sess. (1963), p. 29 8

3 Loss, *Securities Regulations*, pp. 1519-1528 (2 ed., 1961) 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. 1215

HAROLD W. MANLEY, LOUIS PRADAL, JOHN C. RUDOLPH, DONALD K. RUSSELL and AQUITAINE COMPANY OF CANADA LTD.,

Petitioners,

against

DAVID H. SCHOENBAUM,

Respondent.

BRIEF FOR PLAINTIFF-RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI

Plaintiff-Respondent submits this brief in opposition to the petition for certiorari of defendants Manley, Pradal, Rudolph, Russell, and Aquitaine Company of Canada, Ltd. (Aquitaine). The petition seeks review of an *en banc* decision of the Court of Appeals for the Second Circuit (405 F. 2d 215), which granted reargument and upon reargument set aside, in part, a prior panel decision (405 F. 2d 200), reversed a judgment of the District Court for the Southern District of New York which dismissed the complaint (268 F. Supp. 385), and remanded the case for trial.

Questions Presented

1. Do the anti-fraud provisions of the Securities Exchange Act of 1934 (Exchange Act) protect stockholders

of a Canadian corporation whose shares, predominantly owned by United States citizens (Pet. p. 12), are listed on the American Stock Exchange?

2. Is an admitted use of the mails and the facilities of a national securities exchange sufficient to confer jurisdiction upon the District Court to determine whether the anti-fraud provisions of the Exchange Act have been violated?

3. Is a purchase by a controlling shareholder of stock directly from the corporation at a grossly inadequate price, and at a time when it, and not the public, knows of material inside information affecting the price of the securities, a fraud and deception upon the corporation and its shareholders?

Statement of Facts

A. The Parties

Plaintiff is a shareholder in Banff Oil Ltd. (Banff) (1).* He commenced this stockholders' derivative action on its behalf. Banff is a Canadian corporation with its principal offices located at 550 Sixth Avenue, S. W., Calgary, Alberta, (149). It is engaged in the business of exploration for and production of oil and gas (149). At all relevant times, Banff's common stock has been registered, listed and traded on the American Stock Exchange (150).

Defendant Aquitaine is a Canadian corporation. Aquitaine is and was at all relevant times Banff's controlling shareholder, owning at least 40% of its common stock (160). Aquitaine acquired its controlling interest in Banff pursuant to a tender offer made to Banff shareholders on January 15, 1964 (43-44). The tender offer was jointly managed by the New York banking firm of Lehman Brothers and the Montreal firm of Greenshields Incorpo-

* Numbers in brackets refer to pages of the record.

rated (34). After the tender offer was completed, Aquitaine placed three representatives on Banff's board of directors (160).

B. Banff's Exploration Activities

In October, 1964, Banff and Aquitaine entered into an agreement with Socony-Mobil relating to 160,000 acres of Crown reservation land located in the Rainbow lake area of Northwestern, Alberta, Canada (44). The agreement provided that Banff and Aquitaine were to obtain a 50% interest in the land in exchange for drilling two exploratory wells (44). Shortly thereafter, it became apparent that the exploration activities were successful (60). Final confirmation came on March 17, 1965, when tests revealed that the wells contained "oil and gas pay . . . amongst the thickest ever encountered in the province of Alberta" (3-4).

The law of Alberta permits a company engaged in exploration activities to withhold reservoir content information for one year (55-56). During the year, no oil or gas can be produced from the exploratory wells but leases on adjacent Crown Land are open for bidding (55). The company with knowledge of the reservoir content on its test wells enjoys a distinct competitive advantage in the ensuing bidding (56).

Banff availed itself of its privilege of non-disclosure. From March 17, 1965 to March 16, 1966, it did not divulge reservoir content information; though it did disclose other information (60-61).

On March 16, 1966, it issued a press release which, in pertinent part, stated as follows:

> "Today marks the end of one year since the completion of drilling of the Banff Aquitaine Rainbow West 7-32-109-8 W. 6 discovery to a depth of 7,236 feet.
>
> * * *

Following the discovery, successful oil wells were drilled and completed in Lsd. 12-33, three-quarters of a mile northeast, and in Lsd. 10-32, one quarter of a mile north of the discovery. The three wells have been designated the Railbow 'A' pool by the Oil and Gas Conservation Board.

* * *

The total Keg River reef oil and gas pay of 686 feet in the discovery well is amongst the thickest ever encountered in the Province of Alberta and its discovery has stimulated a sharply expanded exploration program in northwest Alberta, northeast British Columbia and the Northwest Territories (3-4)."

C. The Aquitaine Purchase of Treasury Stock

The total actual cost of drilling the exploratory wells was $775,000 (52) of which Banff was obligated to pay 10%, or $77,500 (51). The board, after purportedly considering alternative methods, decided on December 10, 1964 to raise $77,500—Banff's share of the exploratory cost—by selling 500,000 shares of treasury stock to Aquitaine at $1.35 per share, or an aggregate price of $675,000 (52-53). No explanation was given for offering $675,000 worth of stock in order to raise $77,500. Aquitaine tentatively accepted the offer on January 5, 1965 (66). The closing took place on March 16, 1965, (160) the day before exploration activities were completed.

Aquitaine knew of the success of Banff's exploration activities; the investing public would have to wait one year to obtain this information. The purchase price paid by Aquitaine was $1.35 per share, the current market price (52-53). This price did not reflect Banff's successful, but as yet undisclosed, activities in the Rainbow area. A year later, after full disclosure had been made, Banff's stock

traded on the American Stock Exchange at a high of $18 (151). Thus, an investment of $675,000 grew, in one year, to $9,000,000, an appreciation of 13,000%.

D. Prior Proceedings

Promptly after the action was commenced, defendants moved for summary judgment. Based on self-serving affidavits, they attempted to establish that Aquitaine's purchase was not made on inside information, that the resulting 13,000% appreciation was merely fortuitous, and that, in any event, subject matter jurisdiction was lacking because the transaction took place outside the United States and had no impact within the United States. The district court credited the affidavits, denied plaintiff's request for discovery, and dismissed the complaint holding that it lacked subject matter jurisdiction and that the complaint failed to state a claim for relief. On appeal, the court held that the district court had subject matter jurisdiction but affirmed on the ground that no substantive claim was set forth, because defendants' affidavits, which were uncontested, established the absence of fraud and deception.

Plaintiff sought reargument. He contended that he was unable to answer defendants' affidavits because he had been denied discovery and all the relevant evidence was in the exclusive possession of the defendants. Reargument was granted on that issue and, on reargument, the court held:

> "The district court's grant of summary judgment against the plaintiff was acompanied by a refusal of his request for discovery. This court has indicated that summary judgment should rarely be granted against a plaintiff in a stockholder's derivative action especially when the plaintiff has not had an opportunity to resort to discovery procedures [cases omitted]. The plaintiff typically has in his possession only the facts which he alleges in his complaint.

> Having little or no familiarity with the internal affairs of the corporation, he is faced with affidavits setting forth in great detail management's version of what actions were taken and what motives led the affiant to take these actions. Since the facts in such a case are exclusively in the possession of the defendants, summary judgment should not ordinarily be granted where the facts alleged by the plaintiff provide a ground for recovery, at least not without allowing discovery in order to provide plaintiff the possibility of counteracting the effect of defendants' affidavits."
>
> 405 F. 2d at 218.

The Court accordingly remanded the case to the District Court for further proceedings.

The present record contains a complaint, answers, and defendants' affidavits and exhibits giving their version of the facts. Plaintiff believes that the issues are not sufficiently important to merit review. But, if they are, then review should await the conclusion of the trial so that they may be determined on a complete record.

Reasons for Denying the Petition

I

An Interlocutory Order Should Not Be Reviewed, Except Under Exceptional Circumstances Not Present in This Case

A non-final judgment should not be reviewed, except to avert extraordinary inconvenience and embarassment. See *American Construction Co.* v. *Jacksonville Tampa and Key West Railway Co.*, 148 U. S. 372, 384 (1893); *United States* v. *Beatty*, 232 U. S. 463 (1914); See *Di Bella* v. *United States*, 369 U. S. 121 (1962).

The reason for the policy is clear. Subsequent events may make non-final orders moot as the facts, developed in an adversary proceeding, may present completely different issues. Defendants have not set forth any reason why an immediate review is necessary.

II

The Exchange Act Can Have Extra-Territorial Application

In an effort to create an important issue, defendants contend that the Exchange Act does not apply to the challenged transaction because it was accomplished outside the boundaries of the United States. This contention was rejected by all ten circuit court judges. That the Exchange Act can have extra-territorial application is so clear from an analysis of the act itself and relevant case law, as to render the issue of little importance.

Congress announced its intention to extend the protection of the Exchange Act to foreign transactions in the very title of the Act:

> "An Act To provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and *foreign* commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes" (emphasis added), 48 Stat. 881.

Section 2 of the Exchange Act, 15 U. S. C. 78b, which sets forth the necessity for regulation, refers continually to the need for protecting "interstate commerce"; this is defined by Section 3(a)(17), 15 U. S. C. 78c(a)(17), to include "trade, commerce, transportation, or communication . . . *between any foreign country and any State,* or between any State and any place or ship outside thereof" (emphasis added). Congress had the power both under

the Constitution and under the law of nations to legislate with respect to foreign transactions affecting securities markets within the United States and American investors. See, *e.g.*, *Ford* v. *United States*, 273 U. S. 593, 619-624 (1927); *United States* v. *Pizzarusso*, 388 F. 2d 8 (2d Cir., 1968); *United States* v. *Aluminum Co. of America*, 148 F. 2d 416, 443-444 (2d Cir., 1945). As this Court has held with respect to the extra-territorial jurisdiction of particular states, "Acts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a State in punishing the cause of the harm as if [the actor] had been present at the [time of the detrimental] effect, if the state should succeed in getting him within its power." *Strassheim* v. *Dailey*, 221 U. S. 280, 285 (1911). No reason has been shown why Congress would not have wanted to utilize this broad power. The Exchange Act was, after all, intended to "be construed like other securities legislation enacted for the purpose of avoiding frauds, not technically and restrictively, but flexibly to effectuate its remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Research Bureau*, 375 U. S. 180, 195 (1963); see *Tcherepnin* v. *Knight*, 389 U. S. 332, 336 (1967). And, as a later Congress noted, "[I]n principle U. S. investors in foreign securities ought to be afforded the same protections as are provided for investors in domestic securities." S. Rep. No. 379, 88th Cong., 1st Sess. (1963), p. 29.

Defendants, apparently conceding that the district court can assume jurisdiction over a foreign transaction, provided that the transaction has an impact within the United States, contend that the sale of the 500,000 shares had no such impact. They argue that there is no impact because the shares cannot be traded here as they "would not constitute valid delivery of Banff's tax-exempt stock on purchases executed on the [American Stock] Exchange"

(Pet. p. 13). But if the shares were sold for an inadequate consideration, then Banff's shareholders, who are predominantly United States citizens (Pet. p. 12), suffered a heavy dilution of their equity interest. Defendants conveniently ignore this impact.

Finally, defendants contend that even if the Exchange Act can otherwise apply to them, they are exempted from its provisions by §30(b) (15 USC §78dd(b)). That section provides as follows:

> "The provisions of this title or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this title."

The exemption applies only to persons engaged in the securities business, such as brokers, dealers and lenders. It has no application to isolated securities transactions by non-professionals. The reason for the exemption is to free the Securities and Exchange Commission (SEC) from regulating foreign securities markets and foreign brokers, dealers and lenders, unless, in the opinion of the SEC, such regulation becomes necessary. The exemption does not apply to the defendants in this case who do not "transact a business in securities," but engaged in an isolated transaction. The very fact that Congress found it necessary to exempt certain persons raises an inference that others are not exempt.

III

The District Court Has Jurisdiction to Determine the Violation Alleged

a) The mails and facilities of a national securities exchange were admittedly used

Defendants admit that the mails and the facilities of a national securities exchange were present but they contend that their use was not essential to the accomplishment of the violation alleged. It has long been settled under the mail fraud statute (in which the use of the mails is the gist of the violation) that an incidental use of the mails is sufficient. *Durland* v. *United States*, 161 U. S. 306, 315 (1896). The same reasoning applies *a fortiori* to the Exchange Act. See 3 Loss, *Securities Regulations*, pp. 1519-1528 (2 ed., 1961). No court has ever held that the corpus delicti of an exchange act violation is the use of the mails.

b) Fraud and deception are present whenever a fiduciary over-reaches in a trade with his cestui que trust

Defendants also contend that the *en banc* decision of the Second Circuit seems to eliminate the element of fraud or deception as an ingredient in a §10(b) case. The argument overlooks the fact that an act may be fraudulent when a fiduciary relationship is involved even though the same act, in an arm's-length transaction, would not be fraudulent. *Securities & Exchange Commission* v. *Capital Gains Research Bureau*, 375 U. S. 180 (1963). In *Capital Gains*, the defendant urged that the SEC had failed to prove fraud or deception. This Court, in rejecting that argument, held:

> "Nor is it necessary in a suit against a fiduciary, which Congress recognized the investment adviser to be, to establish all the elements required in a suit

against a party to an arm's-length transaction. Courts have imposed on a fiduciary an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients." 375 U. S. at 194.

Conclusion

The decision rendered in this case has none of the far-reaching aspects attributed to it by defendants. It simply reaffirms a well-established rule that defendants who have exclusive possession of the evidence, cannot obtain summary judgment simply by swearing that they did no wrong. Plaintiff must first be given access to the information. See *Poller* v. *Columbia Broadcasting System, Inc.*, 368 U. S. 464 (1962); *Kennedy* v. *Silas Mason Co.*, 334 U. S. 249 (1948).

It is respectfully submitted that the petition for certiorari should be denied.

Respectfully submitted,

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